GETTING AND SPENDING

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GETTING AND SPENDING

AN INTRODUCTION TO ECONOMICS

BY

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1922

With an Introduction by Sir William Ashley

LONDON AND GLASGOW

COLLINS' CLEAR-TYPE PRESS

Manufactured in Great Britain

INTRODUCTION

Mrs Fisher has written a book on elementary Economics which those who come to it with open minds and with a willingness to think over what she says will find both interesting and enlightening. To have produced so animated and yet so judicious a little volume is something of an achievement: it could be accomplished only by one who has learnt as a teacher to enter into the minds of others and who possesses the gift of lucid expression.

The writer of this book stands in the line of spiritual succession to the creators of English Political Economy—to Adam Smith and Ricardo and John Stuart Mill. Her readers will observe with what respect she refers to these masters; and, if they should continue their economic studies, they will find that the fundamental assumptions of the founders of systematic economic teaching are hers also. I must confess that there have been very many earlier books, which essayed the same task in a similar spirit, which I should have hesitated to commend. English Political Economy, when it first presented itself to the world as an ordered body of thought, combined, with much that was true and of permanent value, much that was so one-sided as to be misleading and no little that was simply erroneous. Applied, with the best intentions but with imperfect understanding of human nature, as the adequate explanation and even, in a sense, as the justification, of

the grave social evils of the time it deservedly aroused the fierce antagonism of many of the more intelligent of the working people; and it may be doubted whether, for half a century, it did not do more harm than good. But since Mill's time there has been much fresh thinking among economists and wider horizons have opened to them; and in this treatise of Mrs Fisher it is the more permanently valuable parts of the old teaching which survive, qualified and safeguarded by many of the results of later observation. The author has strong and definite opinions; but the temper of her book is generous and fair minded. She will be very well satisfied, I am sure, if her book sets her readers thinking and makes them realise the strength of the forces she shows to be at work, even if they do not on all points reach the same final conclusions. There may be legitimate divergences of opinion as to the relative magnitude of conflicting considerations. But, in the main, the considerations which Mrs Fisher sets forth—and sets forth with so much spirit—are such as all economists agree to be important; and the general line of reasoning and exposition which she follows with so firm a tread will be found, by most people, the most convenient path of approach to any further examination of the insistent problems of industrial society.

William Ashley.

AUTHOR'S PREFACE

I have tried to keep this little book as simple, easy, and elementary as possible. It is primarily intended for schools, but I hope it may also be useful to older students. There are numbers of excellent text-books for advanced students, but in my own teaching years I constantly longed for something really easy which I could recommend to my pupils as an introduction to their subject. Study Circles, Citizens' Associations, and similar bodies may also perhaps make use of a book which does not profess to be anything but the simplest of outlines. With such needs in view I have added a bibliography. This is purposely very short, introductory rather than comprehensive, but I hope it may be useful to older students and perhaps to the teachers of the younger.

I am only too fully conscious of all that I have left out, of the many aspects of the industrial problem upon which I have not even touched. But if students grasp the elementary outlines, the fundamentals, of the subject, with which alone I have tried to deal, they should be able to understand and work out for themselves the advanced and difficult problems which are of such absorbing interest to all thoughtful citizens.

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INTRODUCTION

ECONOMICS

WHAT DOES THE WORD MEAN, AND WHY IS THE SUBJECT WORTH STUDYING?

HUMAN beings are so many-sided that we have to think about them in different ways. Thus, for instance, there is all the mass of wisdom gathered together by generations of learned men and women about our bodies and minds, a number of different *sciences* as we call them, from the Latin word meaning knowledge. Then there are other sciences which deal with men not as individuals but as members of what we call organised society, that is groups of people living together under more or less settled conditions. Economic science is one of these.

Scientific students try to work out the relation between cause and effect, to discover why things happen in certain ways, and what results certain actions are likely to have. Their object is to discover the truth, they leave it to others to apply the knowledge they obtain. For example, the doctor uses the sciences which deal with our bodies when he tells us how to keep well, or what to do if we are so unlucky as to fall ill. The scientific thinker has provided the knowledge, the doctor puts it into practice. Of

course, many doctors are themselves working at new discoveries which will help them and those who come after them. But when the doctor is thinking out his problems, his one aim is to discover the truth, when he is looking after his patients he is applying his knowledge.

The name *economics* comes from a Greek word meaning the care of the household, and we might describe Economics as the *science of everyday life.* Economists think about men in modern civilised conditions, that is, they think about people who travel in trains and steamships, and nowadays in airships too, who use telephones and telegraphs, live under settled laws, read the newspapers if they want to, know something of what is going on in the world, and are able to decide for themselves where they will live and how they will earn their living. The economist is interested in the *business* side of people, in their ordinary everyday lives, how they earn their money, and how they spend it, how they save, and what they buy. Of course, the business side is in real life more or less mixed up with all the other sides. For instance, how much we earn rather depends on what we want. A young man may want to marry and to provide for any children he may have, in which case he will probably be anxious to get regular work under healthy conditions. Or perhaps he longs to travel, in which case he may become a sailor or join the army. Or perhaps he thinks he is not likely to marry, and only cares to earn just enough to keep himself and to have something over with which he can go to the pictures, or to a football match on Saturdays.

The economist does not try to work out all this

side of life, he leaves it to others. He takes certain things for granted. He assumes that people are willing to work, but that as a general rule they expect to be paid for their work. Or, if they are working for themselves, they hope to produce something pleasant to possess or to give to friends, such as peas and potatoes from their own gardens and allotments, or perhaps pretty clothes. Again, the economist takes it for granted that people who have things to sell will try to get as good a price as they can, while people who want to buy will try to get what they want as cheaply as possible.

Of course, there are exceptions to all these rules, but broadly speaking they are true of ordinary human beings engaged in ordinary business. Thus, a mother making clothes for her baby may not try to get the quickest results with the very least amount of work. But a dressmaker, working for her customers, will feel differently, her object is to earn her living, and although she probably enjoys sewing, she does it for business reasons and not mainly for pleasure. On the whole, any conclusions at which we may arrive, reasoning on these assumptions, are likely to be true (if we reason correctly) in so far as we have to do with ordinary buying and selling and ordinary business affairs.

The economist then is concerned with prices and earnings, with trade, with how we get our food and clothes and furniture, and how they are paid for. He helps us to understand all sorts of things; for example, how it is that we in England can eat bread made in part from wheat grown in Argentina or Canada, butter from Denmark or Ireland, bananas

from the Canaries or the West Indies, tea from India or China; wear clothes made of cotton from Egypt or America, or wool which once grew upon the backs of Australian sheep. He explains to us how and why we obtain all these things. It probably seems to us so easy and natural that not until we begin to think about it do we realise how complicated it all is, and what a number of people must be doing all sorts of things before we can go to the grocer and buy our tea and sugar, or to the green-grocer for our fruit, or to the other shops for our clothes and our sheets and towels and blankets.

There are people growing the corn, and people making ploughs and tractors and reapers and threshing machines, with the help of which the farmers can grow and harvest the corn. And there is another set of people getting the coal and iron and forging the steel to make these machines. And yet other sets of people are busy moving the corn from Argentina and Canada to Great Britain, people on railways, and people in ships, and people working at the docks. Others, again, will be making the railway engines and trucks and the steel rails and the boilers and all the different parts of the ships and trains, and further back still will be the workmen who got the coal and made the steel and other materials out of which the ships and trains were built up.

Then there are the bankers who help to arrange about the payment for all these goods and services; the payments made by the farmers to their men, and for their ploughs and machines, the payments made by the people who buy the corn and move it in the trains and ships, and the people who take it to the

mills to be ground into flour, and finally the bakers who make it into bread. And meanwhile all this immense number of people and their helpers have themselves to be fed and clothed and housed and amused and kept warm and doctored and cared for in a hundred different ways.

A good many grown up people, and indeed many of the children, began to realise something of all this in the days of the Great War, when sugar ran very short, partly because the European countries from which we had been accustomed to buy some of it were too busy fighting to grow much sugar-beet, and partly because the ships which brought it to us were apt to be sunk by submarines. We learnt a good deal too in those days and in the years just after the Armistice about prices, and why sometimes our money will buy a fair amount, and sometimes seems to go no way at all.

But in ordinary life, when there are no wars to upset us, we are apt to take it all for granted, and think little, if at all, about why prices are high or low, or how we come to be fed and clothed and warmed. It would, however, be far better to understand about these things. For they are all quite important, and sooner or later are likely to be discussed in town and county councils, or in Parliament, and laws may be made which will deal with trade or with the conditions of life in certain industries, and with all sorts of matters which a knowledge of economics would help us to understand. And, as we shall have votes when we are grown up, it is very desirable that we should know something about such matters. The laws which are made in Parliament concern us all, and we

have ourselves to thank if we get laws that we do not like. Members of Parliament, or indeed for the matter of that Governments, can really only carry out what they believe to be the wishes of the people who have votes, and the more sensible and thoughtful and capable of forming sound opinions the voters are, the better laws and Governments shall we have.

Therefore, as each one of us is bound to be concerned with trade or commerce, salaries and savings, taxes and rates, opportunities of earning our livings, sooner or later, in one way or another, it is surely very desirable that we should have some knowledge of these things, and have it in a scientific way. Economic science will not tell us that certain things are right or wrong, but what it will do, if we study it carefully, is to help us to understand something of why and how they happen, and what results are likely to follow from various courses of action, as, for example, the passing of laws which affect trade and industry.

If we all learn something of the principles of health, and of what habits are likely to keep our bodies in good condition, we shall become a healthier and stronger race. In the same way, if we all learn something about the business side of life, we are much less likely to make mistakes in government, or to pass bad laws, or to come to unfortunate decisions as to business or industry or trade. Thus we shall be more likely to be a fairly prosperous race, even more likely to be a happy one, in so far as happiness depends upon living under good conditions, and having in all parts of the country and in all walks of life enough to satisfy our needs and desires.

To sum up then: Economics is the study of mankind living under modern civilised conditions, carrying on the ordinary business of life. And the reason why economics is worth studying is partly because it should be one bit of our training for citizenship, and partly because it makes all the ordinary affairs of life, engineering or housekeeping, working in a mill or an office, making clothes or machines, helping to run trains or motors or ships, growing corn or roots, or stock-breeding, so infinitely more interesting if we know a little about all the intricate and wonderful organisation of which each small transaction is a part. Moreover, the more we get used to thinking in a scientific manner, the less likely we are to be led away by wrong ideas of any kind, or by foolish notions, and the more able shall we be to form really sensible opinions which are worth having. So, if we study economics in a scientific way it should help us to be good citizens, to be interested in the work of our daily lives, and to be sensible, reasonable human beings.

SOME EXPLANATIONS

WEALTH AND VALUE

As girls or boys who have studied physics or botany or chemistry will know, most sciences have a special set of words of their own, which are often tiresome to learn or to remember, though they are very convenient when once they are firmly fixed in our heads, and a great help to clear thinking. But one of the difficulties of economists is that they use words which are also used in ordinary life, and very often use them in a way unlike that of ordinary life, and give them a special meaning. So that one of the first things we have to do, in our study of economics, is to be careful that we understand the exact meaning of the words used.

A great many mistakes have been made for want of this precaution, and people have wasted any amount of energy in attacking what they believed to be the teaching of economists, when really the poor economists were quite innocent, and meant something entirely different. That is the difficulty of a study which has to do with the affairs of everyday life, but it is not a very serious difficulty, and it can be got over by making quite sure of our definitions as we go along.

One of the words which we use a great deal is *Wealth*. Indeed one of the definitions of Economics is that it is the science of *Man in relation to Wealth*.

Now what do economists mean by Wealth? The word suggests to most of us great houses, powerful motor-cars, rich fur coats, and jewels. But economists do not mean only those things. They mean, putting it broadly, anything which can be bought or sold or exchanged for something else. Thus marbles are wealth, if a small boy can exchange them for a pencil or top or something else which cannot be had for nothing. And vegetables from our gardens are wealth because we can take them to market and sell them for money with which we can buy something else. Primroses in country lanes or hedgerows on the other hand, are not wealth, because they can be had by any one who will take the trouble to go and pick them.

But may they not be turned into wealth? Suppose they are picked and carried, fresh and delicious, to some one, perhaps a town dweller or an invalid, who is willing to give something in exchange for them? If a country child gathers primroses and trudges a few miles into the town, sells them, so that he can buy chocolate or anything else he wants with what he gets for them, are not the primroses wealth? They are clearly not wealth in the country, where any one can have as many as he likes, if he chooses to take the trouble to gather them. But the child, by moving the primroses to the town where they cannot be had for nothing, has turned them into wealth. He may come home with a little new wealth of his own, pencils or sweets perhaps from the town shops, which he has earned partly by his enterprise in gathering the primroses, and taking them to some one who wants them, partly by his energy and the labour of picking them and carrying them along. He has used Nature's

gifts, his own brain and strength, and the result has been wealth.

It is quite easy to think of things which are sometimes wealth and sometimes not wealth. For instance, thousands of years ago people used polished flints as knives or spear heads. A specially well chipped and polished flint must have been very much cherished by its possessor. Later on men began to use iron and steel weapons, and the old flints lay where they had been thrown, on rubbish heaps and about in the fields. They were no longer wealth. Hundreds of years passed, and we began to be interested in the doings of the long-ago flint-using people. Collectors of curiosities began to seek for these flints and to be willing to give something in exchange for them. Nowadays if any one with sharp eyes discovers a good flint implement out on the downs or in the fields, he might well think of it as wealth.

Sunshine and fresh air are not wealth in the economist's sense, though they are perhaps the most precious things in any other sense. But nature gives them to us freely, and the free gifts of nature are not economic wealth. People who live in smoky towns are ready to pay railways or charabancs to carry them to places where they can bask in the sunshine or breathe the fresh air, but though the railways and charabancs are wealth, the sun and air are not, because any one who chooses to go where they exist can enjoy them for nothing.

The economic student will be thinking of wealth in many different ways. He will be thinking about its production, about the way in which it is divided among different sets of people, about how and why

different sorts of wealth are exchanged, how some kinds last a long while, such as houses, while other kinds, such as food, are used up very quickly. But whenever he uses the word *Wealth* he means something which can be exchanged for something else.

Another of the words which the economist uses in rather a special way is *Value*. Later on we shall think about why some things are more *valuable* than others, but before we go any further we had better make it clear that Value means Power-in-Exchange. That is, anything which has value can be exchanged for something else. So that another definition of Wealth might be That which has Value. Or one might put it the other way round, and say that everything which has value, that is, everything for which something else will be given in exchange, is wealth. The polished flints had value to the Cave-men, and they have value now to the collector, but for hundreds of years when they were neither used nor collected they had no value.

In ordinary life we use the word loosely, often meaning that we like a thing when we say that we value it. But if an economist uses the word, he means by it the power of exchange. So that here we have two words, *Wealth* and *Value*, which have special definite meanings to the economist, and are used in a variety of ways in ordinary life, and we must be careful to remember the economic meaning when we are talking about economic questions.

THE FREE MOVEMENT OF PEOPLE AND THINGS

We have already said that the economist is thinking about people who live under modern conditions, in a

world full of trains and every sort of motor vehicle, people able to write letters and send telegrams and have conversations on the telephone. In a word, the modern world is one in which people can move about with great freedom and ease. Now although this is one of the things that we take for granted, and that seems to us quite natural, it is really rather a new state of affairs.

In old days, and not so very long ago, movement was much more difficult. For one thing, there were not many ways of moving oneself before the discovery of steam. People could ride, walk, or drive, but even the quickest stage-coach took a great deal longer than a motor or a train, while the sea voyages which now take days lasted for months. And then people were much less willing to move about, partly because it was a long, difficult, and tiresome business, and partly because it meant that they would be very much cut off from the friends and relations they left behind. If people took a long time to travel, so did letters, and as for telegrams and telephones, they of course have only come into use in recent days.

So that when the early economic writers took it for granted that people could move about freely wherever they wished, they were really rather ahead of their times. But we surely may take it for granted, because travel is so quick and so easy now that people do move a great deal. And also there are no laws, and very few, if any, customs which prevent such movement within a country, while in the old days, as the historians tell us, people were in all sorts of ways bound to remain in their villages or their original homes, or at least

had a good many difficulties to overcome before they could leave them.

Even in the face of all these difficulties, however, people still did move. If it was thought that there was a good deal of money to be earned in some particular place, somehow or other people flocked to that place. A well-known example, though not a very ancient one, is the movement that took place in England in the early days of the nineteenth century, when the discovery of steam led to such tremendous changes in the methods of work. From all over the country people came into Lancashire and Yorkshire, and the big industrial towns which we now know so well began to grow up.

Nowadays newspapers as well as letters from friends give us accounts of places where the chances of work are good, and it does not take long for people to get to them. We all remember how in the days of the war people came crowding into the munition areas to help make shells for the soldiers at the front. In the most surprisingly short time the great shell shops were filled with workers.

So that on the whole we may agree that the economist is right to take it for granted that people can move about freely, and that, as a general rule, they do. There are, of course, always exceptions. People become attached to their homes and do not wish to leave them, however attractive the chances offered them in some other place may sound. And the expense of moving is a thing that has to be considered. But at any time there are plenty of young men, not yet married, who have only themselves and not a quantity of furniture to move,

and if the prospects are specially good in some particular place, and specially attractive, we may be sure that a number of these young men will find their way to that place. It is not quite the same with young women, because, for one thing, it is more difficult for them than for their brothers to find suitable lodgings, but on the whole they move about very easily too.

Moreover, people are not bound by custom or law to any place or calling, as they are to this day bound by the *caste* system in India, or as they were by the laws of the Middle Ages in England. In India, if you are born a sweeper, a sweeper you remain all your life. In modern England, it does not matter what or who your father is, there is no law and no custom which can prevent a boy or young man from choosing any career he wishes. For a woman things are not quite so easy, for though all legal restrictions have been swept away there are still some customs and a good many prejudices which tend to keep women out of certain occupations. It is no doubt easier for some fortunate people to succeed than for others, but we have only to think of the history of many of our most famous men to-day to realise that not only can one move freely from place to place, but that every year the young men and women entering life can, and to a great extent do, move freely into those occupations which seem to them most attractive. Prime ministers, great generals, leading statesmen, great captains of industry, may, and do, come from humble homes, or from families which have not produced any such distinguished person before.

And if people move about freely, so do things. The knives made in Sheffield are used all over the world,

so are cotton goods from Lancashire, agricultural machinery from Lincolnshire, boots from Norwich or Northampton, hosiery from Nottingham, woollens from the West Riding of Yorkshire, brasswork from Birmingham, motors or bicycles from Coventry. There is nothing to prevent goods from being moved all over the country. As we shall see later, when we come to think about trade between people living in different countries, there are sometimes laws which make it difficult to move things between countries, or indeed for some people to enter easily countries not their own. But within any modern civilised country people and things move with ease and freedom. People can find out by means of newspapers, and trade journals, by telephone calls and telegrams, where to send things, or where to go themselves, and there is every sort of conveyance to take them wherever they wish.

Finally, our modern banking system helps us to pay for these things. If we live in Devonshire and want a set of stainless steel knives from Sheffield, our banks will make all the arrangements by which we can pay for them, or if we are near enough to a town to buy them from the local ironmongers, by which the ironmongers can pay the Sheffield makers. Banks also make buying and selling easy in many other ways which we shall discuss later on. So that when we are thinking of such questions as Wages, or Prices, or Profits, or Interest, we may with great safety take it for granted that both people and things can move all over a country freely and easily, to any place where they are wanted, or to which they wish to go.

PRODUCTION

HOW WEALTH COMES INTO BEING

I.—NATURE'S FORCES

If we are to study man in relation to wealth, the first thing to do is to consider how wealth comes into existence. Looking back, whatever else we may think about the lives of our remote ancestors the cave-men, it is clear that they did not possess much *wealth*. From the economic point of view, perhaps we may think of their stone weapons and the skins which served them for clothing as wealth, but that is about all we can find. In a later stage of civilisation, made familiar to us by the Old Testament stories, we have wealth mostly consisting of flocks and herds. People wandered about, living perhaps in tents, seeking fresh pastures for the animals which supplied them with milk and flesh and skins, and which, therefore, enabled them to live.

Or we can think of man when he first began to settle in one place, tried to cultivate the soil, and grow food for himself. In this stage his wealth would consist of his crops, the rough tools he used in his work, his hut, his live-stock, the clothes and rugs he and his family had spun and woven, the rough pots they had made. As

time goes on, we find wealth of more and more different kinds. We can think of descriptions of Eastern wealth in the Bible, or in the *Arabian Nights,* and the history books tell us how here in the Western world we gradually learnt to increase our wealth in many different ways. But whether we are thinking of cave-men, or of the world in which we live to-day, wealth always comes into being because man uses his brain and his hands, and works upon the free gifts of Nature.

Nature gives us water and the power of growth, and fire and different clays and minerals and many sorts of plants, and animals which we have tamed as well as the wild animals whose skins we use to keep out the cold. And with fire and water we have made steam, and since the discovery of steam we have learnt to use another of nature's gifts, electricity, to do work which otherwise would have had to be done by sheer muscle and energy and exhausting labour. More and more, as the centuries have passed, has man's brain shown him how to use nature's forces instead of his own to perform the heavy laborious work of the world.

The great blocks of stone which in the days when the Pyramids were built must have been moved by hundreds of sweating, toiling, exhausted men, are now swung into the air, raised hundreds of feet, and placed in exactly the right position by a steam crane, managed with scarcely any effort by one man. Steam and oil and electricity, nature's gifts, are harnessed by man to move himself and his goods all over the world, to weave and to spin, to cut great billets of steel as if they were butter, to light and warm his buildings,

to do all sorts of things which without their help either could not be done at all, or could only be done by using a very great deal of human energy. Nature offers her gifts freely, but it is man's skill of brain and hand which turns them into wealth for man's use.

Economists are accustomed to think of one of Nature's gifts, *land*, as a little different from the rest. They tell us that it is limited in quantity, which is obvious, and variable in quality, as every farmer or gardener knows. Moreover, most of it in old countries belongs to some one, or to some body of people. Only in the new and undeveloped countries is land still to be had for the taking. But whether we think of land or of any other of nature's gifts, we realise that all wealth comes into existence through the combination of man's forces with nature's powers. The *factors of production* then, as the economist tells us, are *man's forces and nature's gifts.*

We know that some countries are richer than others, and it is interesting to try to find out why. One fairly obvious reason is that Nature has been a good deal more generous to some of us than she has to others. Countries vary very much in *climate.* Some suffer from torrid heat, which parches up vegetation and exhausts man and beast, some from terrible droughts, which lead to the death of thousands of animals, some are wrecked by earthquakes, some frozen by months of bitter cold. In some the soil is naturally of great fertility, though we realise more and more that, at all events in old countries, the fertility of the soil depends at least as much upon how it is treated by man as upon how it is helped by Nature.

Some countries, such as our own, owe a great part of their wealth to the rich deposits of coal beneath the surface of their soil, others to the existence of gold or precious stones, while it may well be that in the future those countries which have abundant water power and can therefore make electricity cheaply and easily will be among the richest. The rivers that run down from the Alps into Northern Italy, the huge waterfalls of Niagara or of the Zambesi, are capable of being sources of immense wealth to mankind. Abundant water supplies, a temperate climate, coal or oil or other mineral deposits, are all pleasant possessions for any country, and likely to increase the wealth of its inhabitants.

II.—MAN'S WORK

Suppose that we were continuing our inquiry into why some countries are so much wealthier than others, and had reckoned up what Nature had done for them, we should probably go on to inquire what sort of people lived in them. What of their population? Is it healthy and intelligent and industrious, or diseased, stupid, idle, vicious, ready rather to get along anyhow than to make efforts and to improve things? However generous Nature may be with her gifts, no country will be wealthy unless its people are efficient, while an intelligent and hard-working population may bring great prosperity to a country for which Nature has done but little.

There are always some people in every country who are eating food and wearing clothes and living

in houses and using furniture, and in many ways doing what economists call *consuming* wealth, but who are not doing anything to help produce wealth. There are also a good many more who are helping, but who do not produce as much as they consume.

This is not at all the same thing as saying that there are numbers of people who are not being paid for their work. Some of the work which is not paid for is often the most useful to the community. No one pays mothers, for example, and yet the world would soon come to an end if they did not spend much of the day and often a good part of the night as well, in working for their children. And in every country, perhaps especially in our own, there is an immense amount of work done which is not paid for, but which is of great importance, and without which the community would be certainly poorer. For instance, there is all the work done by magistrates, or by members of town councils and other local bodies, and by all sorts of people in all sorts of ways. It is quite possible that some of the people who work hardest, and who are not paid for a great deal of what they do, are among the most useful.

But what we do find is that there are also everywhere some people of whom it would be true to say that the country would be richer if they were no longer in it. There are the people who do not like work, whether with their brains or with their bodies, and who manage to get along without doing any, or at all events with remarkably little. And there are those who cannot work because they are ill in body or in mind. Most of these last we may hope are only

unable just for a time to contribute their fair share to the country's work. And of course there are all the children; but it is hardly fair to count them with the invalids and the idlers, for they are busy growing up, and in due time may be able to help in producing more than they consume, so that over the whole period of their lives they may have given as much, or more, to the community than they have taken out of it. There are also the old: but in the same way we may assume that in their working days they have produced enough to maintain them in their old age.

Nor must we be too narrow in our definitions. There are many people who do not seem exactly to be adding to the nation's wealth, such, for instance, as violinists or singers. But probably we shall be right in thinking that it is well worth the while of their fellow human beings to support them, because the immense pleasure their musical skill gives to us ordinary people so refreshes us that we are able to go back to our own work and do it all the better for having listened to them.

There are, too, others whose work may seem of no value for the moment, such as the work of the men and women who give their lives to research. They may perhaps get no results for years and years. But in the end they, or those who come after them and use their work, may make some discovery which will enormously affect the health or the happiness of mankind. Again, there are many who are indirectly contributing to the prosperity of the world by the help and care they give to those who are actually working. Without such help the work done might

well be less in quantity or inferior in quality, or both.

In a simple community, such as a small village in the Middle Ages, it would have been perfectly obvious if any one tried to consume more than he produced. But in the modern world it is difficult to know just where to draw the line between what an American writer calls *Economic Men*, that is, those who give to the community directly or indirectly as much or more than they take from it, and *Social Debtors*, that is those who take more than they give. But we shall be fairly safe in saying that the larger the proportion of economic men, and the smaller the number of social debtors there are in any community, the more prosperous is that community likely to be.

CAUSES OF THE EFFICIENCY OF MAN'S WORK

1. *His Body.*

Thus, then, the prosperity of a country depends partly upon the proportion of its people who are producing as much as, or more than, they consume. But it also depends on *how much* they produce, and this depends, among other things, upon the health of the people. We are only slowly coming to understand the immense importance of good health. For many a long day doctors and thinkers have been trying to get it into the head of the ordinary average citizen that ill-health and poor health are not only expensive but unnecessary, and that it is far more important to keep people well than to cure them when they are ill.

If bad health is unpleasant for an individual, so it is for the community. The more sick people there are the more work will have to be done by those who keep well and strong, and the less they will have for themselves, because what they produce has to support them and the invalids as well. So that one of the very first things necessary for a prosperous people is a general knowledge of the laws of good health, and a general desire to abide by them.

We have some way to go in this country before we get to that position, but we are improving. Gradually we shall come to believe that a proper respect and care for our bodies is a part of good citizenship, and that we have no right to give other people trouble or involve them in expense because we like to eat and drink unwholesome things, or more than is good for us, or because we are too lazy to take enough exercise, or because we have not trained ourselves to be able to control our bodies and to have good habits of life. And as we come to realise all this we shall appreciate also the economic importance of having enough houses, and having houses of the right kind, dry and airy and light.

Nature gives us sunshine and air, but if we do not make use of her gifts our health will be the worse. We have learnt the importance of clean drinking water, and in this country we practically never have waves of the kinds of disease which are caused by the use of impure water, though not so very long ago those diseases were common here, and still are in other lands. We have a good deal to learn in the matter of clothing and food. On the whole people are more sensibly clothed than they were, but any one who walks about our streets with open eyes will certainly

see a good many examples of the unwise use of clothing. Some people wear too much, some do not wear enough, and some wear clothes of the wrong kind or in the wrong places.

In the matter of food, too, we are, it is much to be feared, a very long way yet from making the best use of our supplies. On the whole, we are a well-fed nation, but a Frenchwoman or a German would think rather little of our housekeeping and cooking. If they wanted to be unkind they might tell us that we wasted at least as much as we used, and that we often used very expensive foods when cheaper kinds would be as nourishing and as pleasant.

We British are always supposed to be very unwilling to make changes in matters of food, but we were obliged to learn a good deal about 'substitutes' in the days of the war, and perhaps we may have profited by what we learnt. We have certainly become a good deal wiser in the course of the last twenty years or so as to the feeding of young children, and there is every reason to hope that nowadays children have a better chance of growing up with good digestions and strong bones than they had twenty or thirty years ago.

2. His Mind

If healthy bodies, well trained to respond to their owner's wishes, bodies well developed and under perfect control, are what we should desire, so too are healthy and well-trained minds. Some races, and some individuals, may be naturally more intelligent than others, but all of them are capable of immense improvement if they are really well developed. In other words, the nation which most completely understands what *Education* is, what it can do, and how

tremendous is the importance of a really first-rate educational system, will be likely to go ahead. The best educated race will always have a great advantage over those which are less well educated.

Education, of course, means very much more than just book-learning: it means the training of every part, of body, mind, and soul. A complete system of education would give to every child this general training, and would as well provide all kinds of special training for the older girls and boys. Those who were clever with their hands would learn to use them, those who had special tastes for scholarship, or science, or literature, or music, or machinery, or sewing, would all be able to get the training which would enable them to make the very best use of their own special gifts. In a modern state every kind of work is needed, and what is important is that every kind should be done as well as possible. It is also worth remembering that education opens out all sorts of ways of spending one's leisure time. People who have no tastes or hobbies are apt to use their leisure in a manner that makes them less instead of more efficient.

Some countries believe more in education than others, and understand better what it means. We may be pretty sure that those countries will become the most prosperous.

3. *His Character.*

Lastly we come to the social and moral sides of life. It is easy to understand that people who have a high standard of honesty are more likely to be prosperous than those who are less honest. Allotment holders sometimes find it necessary either to take it in turns to guard their crops, or else to pay a watchman

to do so, because of the dishonesty of some of their fellow citizens, who would steal their early peas and beans. This is clearly a wasteful state of affairs, for one man, who might otherwise have been producing something, or resting, and thus becoming more able to do his work well, has to spend his time watching over the crops. Every nation has to spend a great deal upon policemen, and much of that spending would not be necessary if people were more honest. Punctuality, honesty, sobriety, indeed all the ordinary everyday virtues are extremely important when we come to reckon them up from the economic point of view.

4. The laws under which he lives.

Let us imagine, then, that the people of a country are healthy, intelligent, well educated, and virtuous. Is there anything else to be thought about, before we come to discuss the arrangement and planning of work? Much depends upon laws and customs. If a country is unsettled and lawless, who will care to produce more than enough for his own needs? What is the use of working, when robbers, or bands of enemies may seize everything? There are parts of the world to-day where the peasants do not care to produce more than the very smallest crops, because they know that they are liable to be robbed of everything. There are others who grow enough just for their own needs, but no more, because anything more than is actually needed may be taken away. Nothing is so discouraging as the feeling that what you produce may be taken from you, and little or nothing given in return. Lawlessness and disorder are fatal to prosperity, and the history books tell us how over

and over again a long period of peace has made it possible for a country to increase its wealth.

But apart from wars, a good deal depends upon the kind of government in the country. The certainty of getting real justice is very important. One of the reasons why people are sometimes unwilling to work as well as they are really able to do is because they believe that some one else, and not they and their own families, will reap most of the benefit of their work. Good laws, security, both as to life and as to possessions, justice, the feeling that it is worth while to do your best, and that nothing but your best is worth doing are all of the greatest importance if a nation is to be really prosperous.

THE PLANNING AND ARRANGEMENT OF WORK

We have been thinking of all the causes upon which the efficiency of the individual worker depends: his health, his mind, his character, and his sense of security. Next we might consider the arrangement and planning of his work.

When we turn our minds back once more to the early stages of civilisation, we find every one doing more or less the same thing. The men hunt, and the women care for the fire and cure the skins. Or the men work in the fields, and the women help them, and there is weaving and spinning to do as well. Very soon men discover that by joining together they can move a heavy log, or carry out some other operation which one man, however hard he tried, could never do by himself. But it is easy also to

imagine how one or two of the men, bolder or quicker of eye than the rest, became the best hunters, and how their fellow villagers might consent to do their share of work on the land while they went off into the forest for a few days' hunting.

The result of this *division of labour* might well be more food in the end for the villagers than if they had all stayed in the fields or all gone off to hunt. Or again, we can imagine one of the villagers, lamed perhaps by an accident, or in some way not strong enough to take a full share in the ordinary work of the village, finding that he could spend his time on making pots, or arrows, or spearheads, and made them, by constant practice, so well, that it was worth while for the other villagers to keep him supplied with food in order that he might provide them with pots or weapons. And thus gradually we get to the idea of separate trades, of division of labour, and the exchange of produce.

In the Middle Ages each little group of people would have perhaps its smith, its fletcher or arrowmaker, its wheelwright, and other people who had special skill or did special work. Each of these would be particularly good at his own job, and would be supplied by the other villagers with food and clothing in return for his work in shoeing their horses, mending their tools, and making their harness. As a matter of fact most of these people would also cultivate a little bit of land, but not so much as the other villagers, and here again it is clear that this division of labour leads to an increase of wealth.

If the farmer had to stop ploughing for a few days while he mended his harness, sharpened his tools,

shod his horses, he might lose the best of the weather, and as a result have a poor crop. Besides this, he would be slow and not specially clever at these different jobs, as he would only have to perform them occasionally. If, on the other hand, the smith can shoe his horse, and the leather-worker mend his harness, things which they can do quickly and well because they are specially trained to do them, and also because they have increased in speed and skill by doing them constantly, every one will be better off. When the harvest is gathered in there will be more food for the village.

In our own day this *division of labour* is carried very far. It takes any number of different people to make a pair of boots or a saucepan or a bicycle, each doing one small part of the whole. The famous Scot, Adam Smith, who lived in the middle of the eighteenth century, and whose book upon *The Wealth of Nations* is one of the greatest English works on economics, gave a well-known and often quoted account of the advantages of the division of labour. He described the way in which pins were made, and pointed out how, owing to the division of labour, an enormous number of pins could be turned out in a short space of time, and with very little effort on the part of the makers.

'One man draws out the wire; another straights it; a third cuts it; a fourth points it; a fifth grinds it at the top for receiving the head; to make the head requires two or three distinct operations; to put it on is a peculiar business; to whiten the pins is another; it is even a trade by itself to put them into the paper; and the important business of making a pin is in this

manner divided into about eighteen distinct operations, which, in some manufactories are all performed by distinct hands, though in others, the same man will sometimes perform two or three of them. I have seen a small manufactory of this kind, where ten men only were employed, and where some of them consequently performed two or three distinct operations. But though they were very poor, and were therefore but indifferently accommodated with the necessary machinery, they could, when they exerted themselves, make among them about twelve pounds of pins in a day. There are in a pound upwards of four thousand pins of a middling size. These ten persons, therefore, could make among them upwards of forty-eight thousand pins in a day. Each person, therefore, making a tenth part of forty-eight thousand pins, might be considered as making four thousand eight hundred pins in a day. But if they had all wrought separately and independently, and without any of them having been educated to this peculiar business, they certainly could not each of them have made twenty, perhaps not one pin in a day, that is certainly, not the two hundred and fortieth, perhaps not the four thousand eight hundredth part of what they are at present capable of performing, in consequence of a proper division and combination of their different operations.'

The advantages of such a division of labour are then fairly easy to understand. A person who does one job becomes quicker and quicker at that job, as his mind and his muscles form the habit of doing it, and, what is just as important, he can do it with much less exertion. If he is continually laying down

his tools and looking for others, continually changing his task, he wastes not only time but energy. Moreover, time has previously been wasted by his having had to learn many different kinds of work.

On the other hand, doing one thing, particularly if the thing is not in itself interesting, over and over and over again, is monotonous and tiring. Nevertheless, there can be no doubt that the *division of labour*, if it is well planned and skilfully carried out, means that a very great deal more can be produced with very much less effort, and in very much less time. Perhaps, therefore, we may fairly hope that as we come to have an even greater command than we have at present over Nature's forces, and when we can make electricity or steam do even more for us than they do now, the needs of the world may be supplied with comparatively little human effort.

In other words, by the help of machinery, by the help of brains, by clever planning and thinking, the world can be clothed and fed and warmed and moved and provided with all the necessities of life, while at the same time the workers need work only for a few hours daily. The better the planning, the more perfect the organisation, the shorter and the less tiring need be the working day. It is perfectly possible to imagine a world in which a comparatively short working day will be all that is necessary, while at the same time there will be abundance of the things that people need.

Indeed, we are steadily getting towards this. Adam Smith's pin-makers probably, indeed certainly, worked for many more hours in the day than makers of pins or any other factory workers do to-day in Great

Britain. And in such a world, even if the actual tending and watching a machine is rather dull and monotonous, as long as it is not done for too long at a time, or for too many hours in a day, it is not, or ought not to be, particularly tiring. At the end of the short working day every one would have plenty of energy, as well as plenty of time, for all sorts of other occupations—music, books, acting, debating, motoring, cricket, swimming, or anything else that specially appeals to their tastes.

Different people have different ideas of happiness, but when we are thinking about the production of wealth it is impossible to doubt that the division of labour, intelligently planned and carried out, means an enormously increased production at a very much smaller cost of human effort. Our ancestors, in the days before machinery, worked for very long hours, and were often short of food, while what they had was apt to be monotonous in kind and limited in quantity. They were without most of the comforts we take for granted. It is not the fault of machinery, nor of the division of labour, but of man, that there has been so much trouble and suffering since the discovery of steam and the use of machinery on a large scale. Rightly used, machinery should bring much happiness to mankind, because by its use man can produce a very great deal of all the things he needs, with very much less work and in infinitely less time.

CAPITAL

WHAT IS CAPITAL? HOW DOES IT COME INTO EXISTENCE AND WHAT DOES IT DO?

In early days man had very little *wealth*, and what he had was soon used. The wood which he (or more likely she) collected for fuel was soon burnt, the food quickly eaten, the weapons soon lost their sharp edges. By-and-by man began to realise that by *putting off* using his wealth at once, he could manage to have more of it. For instance, let us imagine he found some sort of corn growing wild, and learnt how to thresh it and grind it roughly and turn it into food. Then it occurred to him that a great deal of time and trouble might be saved if he could grow his corn all in one place, and especially if that one place could be near where he found it convenient to live, the sheltered corner, or the neighbourhood of running water. So he roughly cleared a bit of ground, and then in the autumn, when he gathered the corn, he *saved* a part of it for seed, instead of eating it all. It meant that he had less to eat that winter, but that later on he would have more. The children could scare away the birds or animals which liked to eat the corn as much as he did, so that a better crop would result; and also less would be wasted in cutting and carrying if it grew near home. So that the result of going a little short one winter was more to eat the next.

We can proceed a little further. Man began to think that his crops would be further improved if he could cultivate the ground on which he grew them, and for this he needed tools. So he devoted some days, perhaps a good many, to making, as well as he could, the tools he wanted. This meant that for several days he could neither hunt, nor search for wild fruits, nor doze in the sunshine. Instead of spending his time in getting something he would use at once, or in resting, he spent it in getting something which he could go on using for some time. He had now a little *capital;* seed corn, and tools.

This brings us to another of the words which need defining. *Capital* means *that part of wealth which is used to produce more wealth.* In our story, the seed and the tools were capital, very simple forms of it, but certainly capital. They were forms of wealth, for in the first place they had value, people would have been willing to give something else in exchange for them, and in the second they were, instead of being used up at once, used indirectly, to make more wealth. Man might have eaten the corn, and burnt the wood out of which he made his tools. But instead he sowed the corn, and used his tools, and as the result increased his wealth. He had learnt to look forward, to do without something in order later on to have something else.

As time went on, man had more and more capital. He learnt more and more to *save,* that is, not to use his wealth up at once, in the obvious manner, but to use it indirectly in such a way as to increase his wealth. He caught a wild goat, and instead of killing it and eating it, he tamed it, saw that it had food all through

the winter, and then in the spring his trouble and forethought were rewarded. The goat had kids, and if they throve, and also if he could restrain himself from indulging in a delicious meal of roast kid, he would have by the end of the summer one goat and two or three half-grown kids, and besides that, he would probably have had some goats' milk for his own food. He had become a *Capitalist,* he owned the beginning of a herd, which would, in due time, and if the future kids were allowed to grow up instead of being eaten, become a herd. *Capital* is the foundation of all our modern civilisation, and it all comes into existence in the same way, that is, by putting off using some particular kind of wealth to satisfy the needs of the moment, and by using it instead to produce more wealth in the future.

As time went on our friend the early man increased his capital. He came to have not only flocks and herds, but buildings to shelter himself and his animals; he spent time and work in making fences round his cultivated ground to keep out the wild beasts. The women learnt how to spin, they made some sort of loom and they wove rough cloths. They accumulated a number of tools and household implements. All these are capital, because they are wealth which is used directly or indirectly to produce more wealth. And as son succeeded to father, quite large accumulations of capital, such as the flocks and herds of the Old Testament, came into being.

Some of the capital, for instance the seed corn, the dried goats' flesh, is of a kind which can only be used once, the seed corn when it is sown, the goats' flesh when it is eaten. The meat may be regarded as

capital, because man saved it to eat in the winter, a time when fresh meat was hard to come by because of the scarcity of food for animals, and if he had had no meat to eat, he would have been less able to do hard work, digging perhaps and cleaning his fields. It was used indirectly to produce more wealth, by feeding and strengthening him. His tools, on the other hand, could be used over and over again, though in the end they would wear out. The kind of capital which can only be used once is sometimes called *Circulating Capital*, the kind which can be used many times *Fixed Capital*. Circulating capital is, of course, constantly being used to make fixed capital.

Old countries are likely to have a good deal of fixed capital, buildings of all kinds, bridges, water-works, all sorts of machinery, furniture, scientific tools and apparatus, plant for making gas or electricity. In a simple state of civilisation there is likely to be much less. It takes time to get together all these things. It is also, of course, true that most of the fixed capital of a country will probably be in the towns and the industrial areas. Less fixed capital is needed in the country, though even there we find a good deal, houses and farm buildings, agricultural machinery, fences, walls, gates, wagons, carts, and motors.

To sum up. Capital is wealth which is used directly or indirectly to make more wealth. It is the result of saving, that is, of putting off the use of wealth and keeping it instead for use in an indirect method. The corn was sown instead of being eaten, the goat kept to produce milk and kids, instead of being killed for food, the wood made into tools instead of being

thrown upon the fire. The saving may, of course, have been done by some one other than the owner of the capital, who may have acquired it by force, by gift, or by inheritance. Wealth which is used as capital may be used all at once, or its use may be spread over long or short periods of time, but in any case, if it is used to produce more wealth, it is capital. All wealth *may* be capital, but only that part of it which is used to produce more wealth *is* capital.

CONSUMPTION OF CAPITAL

If all capital comes into being as a result of saving, it is equally true that all capital must be *used*, or, as economists say, *consumed*. It is only as it is used that it does its work of helping to create new wealth. If the seed corn had never been used, but hoarded away and in the end forgotten it would never have produced a crop of fresh corn. It would have been capable of becoming capital, but unless it were sown it would not do the work of capital. All capital must be consumed, though the consumption, that is, the using, may take a very long time indeed. It seems absurd to talk of a solid building being consumed, but in actual fact every few years it will need repairing, inside or out, and it may well be that in the course of time nearly all the original work, or at least a very large part of it, will have been used up, worn out, and will have been replaced by new. Circulating capital is obviously used and consumed at once, corn when it is eaten or sown, coal when it is burnt.

Wealth is constantly changing its form as man

deals with it, and his methods of turning one kind of wealth into other kinds often become less and less direct, and mean the use of far more capital as his inventions and discoveries increase. For instance, the rough cloths woven and spun by the ancients were produced with a great deal of work, but not much capital. Our modern cloths are the result of work certainly, but also of an immense amount of different kinds of machinery. Enormous quantities are produced. The West Riding of Yorkshire makes woollens almost by the mile, and these quantities can be turned out because gradually so much capital has been collected to help in their production. By degrees the machinery wears out, the buildings have constantly to be repaired. The capital is all the time being consumed, used up, and out of what they get for the cloth the owners of the capital must constantly put aside enough to renew and replace their machinery, and to keep their buildings in repair.

DESTRUCTION OF CAPITAL

One of the reasons for the unemployment and trouble all over the world after the Great War was the rapid using up of capital. This happened in several ways. The most obvious, of course, is the actual *destruction* of capital as a result of war. Even here in Great Britain, where we suffered comparatively little from actual destruction, the air raids ruined a certain number of buildings, and others on the East Coast had to be pulled down in order to arrange for defence works. In France, as we all know, miles and miles

of country were devastated, the fruit and other trees killed, the buildings blown to atoms, all the machinery and furniture utterly destroyed, The costly and elaborate machinery of the mining area in the north went to rack and ruin, the mines were flooded, the sugar mills and other factories reduced to skeletons or to nothing at all. The result is that the whole world is poorer than it would otherwise have been. For all this immense amount of capital, if there had been no war, would have been hard at work producing wealth. In time it would all have been used up, but meanwhile it would have poured out tons of coal or of sugar, and of all sorts of manufactured goods, and though it may be said that war only destroys at once what anyhow would sooner or later be used up, it destroys it before it has had time to do its work of producing more wealth.

Nor is this nearly the end of the impoverishment due to war. For, when the war is over, and the immediate destruction stopped, not only is the world the poorer for want of all the wealth that the destroyed capital would have produced, but a great deal of *new* capital, which otherwise might have produced other new wealth, must be used instead to replace that which has been destroyed. So that as a result of the destruction of Northern France we are all poorer than we should otherwise have been, for not only have we not got what Northern France would have produced between 1914 and 1918, but neither can we have the other wealth which would have been produced if the world had not had to supply capital, after the war was over, for the rebuilding of Northern France, and indeed of all the buildings and crops and forests

and factories destroyed by the war all over the world.

War makes us poorer in another way. While it is going on immense quantities of wealth have to be used, not for production, not, that is, in ways which will lead to the creation of fresh wealth, but for destruction. All over the world vast masses of steel and many sorts of chemicals were being turned into guns and shells and explosives. Men and women were working day and night, in all the fighting countries and many of the neutral, to turn materials into weapons which would destroy human life and the wealth which was the result of human work. So that in this way too the world is impoverished, because if it had not been for the war, all the steel and iron might have been turning into locomotives and turbines and boilers and steel rails for trams or trains, and a thousand other things useful to man, and likely to give him pleasure and satisfaction. Moreover, huge quantities of food, of locomotives, of motor lorries and motor bicycles, and all sorts of other things, were spoilt and destroyed in the war. As time went on all the fighting nations learnt to check this destruction to some extent, and to perform almost miracles of 'salvage.' But even at the very best huge quantities of useful things were hopelessly damaged before they had had time to be much used.

War, at all events modern war, is perhaps the greatest of all destructive agencies, but Nature sometimes does a good deal of destroying, by fire, flood, or earthquake. The result of them all is the same: the destruction of wealth and the impoverishment of mankind. Capital which might and would have

created new wealth has instead to be used to take the place of that which has been destroyed. Man will have to work harder and to do without things which he might have had, because of the destructive forces either of Nature or of his fellow men. The more highly developed, from the economic point of view, a country is, the more destructive are the results of war or of Nature's upheavals. In early days countries might have been ravaged by the passing of an enemy army, but in a few years they would recover, and this is still more or less true of countries, or those parts of a country, which are mainly agricultural. Crops may be burned, but if there is some seed corn, some implements, and labour, in a few seasons crops will be growing as well as of old. It will take longer if orchards are destroyed, and the more carefully cultivated a country is, the better fenced and drained, the better provided with buildings, the more difficult it is to restore it, and the greater the amount of capital that will be required. So that the more developed countries are, the more machinery, buildings, factories, and so on, they possess, the worse they suffer from destructive forces, whether human or natural.

CAPITAL MUST BE 'CONSUMED' OR USED

Probably even in peace and prosperity a good deal of capital is to some degree wasted, ceasing to be useful before it is worn out, or never being useful at all. But most capital is hard at work making fresh wealth, and using itself up in the process. It is only in times of war or earthquake and flood that capital

is destroyed without not only replacing itself, but doing that and making something more into the bargain. It seems clear that if the work of capital is to make wealth, the amount of wealth that can be produced must depend a good deal upon the amount of capital available. If early man had been so hungry that he had eaten his seed corn and his first goat he would not have had his crops or his herds.

At any moment the amount of new wealth that can be produced depends largely upon the amount of food and other things that are necessary to keep the workers going, the amount of raw material, wool or cotton or flax, or iron ore, which can be provided, and the amount of machinery with which to work it up. At any moment, that is, putting this into other words, the amount of new wealth must depend upon the difference between what is *consumed* and what is *produced*. How much this is will depend partly upon the efficiency of man, and partly upon the way in which he likes to use what he has.

Suppose for a moment that some one has a certain amount to spend. The first thing he has to do is to keep himself as efficient as possible. He might spend just as much upon food, warmth, clothes, shelter, recreation, as would keep him as efficient as he could possibly be. But he may have more than enough for this, he may have something over. What will he do with that? Suppose he happens to be specially interested in food; he may spend it on rich foods and choice wines. What will be the result? If he has an excellent digestion, he may be none the worse, but it is quite possible that he may do some damage to his health and gradually become less efficient,

in which case every one will be slightly poorer, because he will be able to do a smaller share of the world's work than he was originally capable of doing. He may spend his surplus in any one of many thousand different ways, which will either make no difference at all to his efficiency, or else render him less efficient. In the first case, things are as they were, no better and no worse; in the second, every one suffers a little.

There is another possible course for him to pursue. We are supposing that our imaginary friend has not only enough to keep him as efficient as possible (lucky man) but something more. Suppose he decides not to use this extra amount, but to 'save' it. What then? He might lend his surplus to his neighbour, a farmer, who badly wants a new machine, but has not been able to afford it. The farmer, with the help of the new machine, gets a better crop and in a year or so new wealth will have been created, and every one will be slightly better off as a result.

As a matter of actual fact, *saving* is done by the help of *Banks*. What really happens is that people who save entrust their extra money to banks. The banks lend it to those people who want more capital, in order to produce fresh wealth. *Hoarding*, that is storing away extra wealth and neither using it nor lending it to some one else to use, is not saving: hoarded wealth lies idle and does not create more. To return once more to our early cultivator, he *saved* corn for seed. If he had never used it but hoarded it away in case some day he might want it, no fresh wealth would have come into existence.

THE EFFECT OF SPENDING UPON CAPITAL

Now if we come to think this over clearly and carefully, we shall arrive at some probably rather unexpected conclusions. One is that it matters not only to ourselves, but to every one else, how we spend our money. If we spend it in ways that do not make us more efficient, or in ways that make us less efficient, we are preventing new wealth from being created. Very few people realise that the way in which they spend their money concerns any one except themselves and perhaps their own belongings; but actually it matters very much to every one. From the economic point of view, money which is spent in a way which does not make people more efficient, or which makes them less efficient, is *Waste*. Of course the economic point of view is by no means the only one to be considered in real life, but it is an extremely important one, and it is quite possible that if it were more generally understood we might all be a great deal more comfortably off.

One sometimes hears people say cheerfully, to console themselves for having fallen down with a trayful of china, or let an apron catch fire, 'Never mind, it's good for trade.' But is it? It may be good for the china trade, when china falls, but it is not at all good for trade as a whole. What really happens is that some capital, and some work which otherwise could have been used to make fresh wealth has to be used to replace the broken china. The breaker might have had the trayful of china and something else as well, or if she did not want anything else she might have

'saved' her money and lent it to some one else who did. As it is all she has is the china, and neither she nor the some one else has any more.

Unfortunately, in the world as it is to-day there are only too many people who have nothing at all over and above what is needed to keep themselves and their families perfectly efficient, and only too many who have not enough even for that. This unsatisfactory state of things exists partly, no doubt, because what wealth there is in the world is not divided among the people in the world as well as it might be, but also because much less is produced than might be. All the more, therefore, is it important to think about how we spend what we have, because what people wish to buy determines what other people have to make. Each little buying by itself may make hardly any difference, but all the little buyings taken together make all the difference. If people insist on spending money on more alcohol, or for the matter of that more sweetstuff, or more anything, than they need to keep themselves efficient, then more capital and work must be put into the alcohol or sweetstuff business, and less is available to create fresh forms of wealth, or to make something of which there is not yet enough.

Economic waste means not only the destruction of wealth, but also its use in any way which does not, directly or indirectly, help to make people more efficient. It is extremely difficult to draw a hard and fast line between what is waste and what is not. Most of us can think of some ways of spending money which are clearly and certainly waste. Getting drunk is one, eating strawberries in Great Britain in December is another. Undoubtedly the capital and work which

are spent in producing the alcohol which results in drunkenness, or the strawberries grown only with a great deal of artificial heat and elaborate glasshouses and great care, could be far more productively used in other ways. But short of these extreme examples most people can probably think of other forms of waste within their own experience.

As in many other matters, it is extremely difficult to know where to draw the line when one is thinking about other people, but fairly easy, if one is honest, to judge about where that line is for oneself. It certainly makes the question of one's own small spendings enormously more interesting when one realises that upon them and all the other small spendings of all the other individuals, so much depends. The greatest need, economically, after a tremendous war, is for the wisest use of the wealth that is left, and for saving, in order that fresh supplies of capital may take the place of all that has been destroyed. Wealth used to increase efficiency, or *saved* and used as capital which creates fresh wealth increases prosperity: wealth used in ways that do not increase efficiency or that diminish it, or wealth hoarded, make the world less well to do than it might otherwise be.

Each time one makes a purchase one is helping to do what economists call *create a demand*, that is, one helps to direct capital and work into some particular channel. If that channel leads directly or indirectly to the creation of fresh wealth, it is used economically. If it is used in a way which creates no fresh wealth it is destroyed, comes to an end. The person who used it may have had some satisfaction from his use, but no one else will ever benefit by it.

Another unexpected result has now appeared, and that is that it is impossible to *make work*. All that can be done, to begin with, is to decide what sort of work shall be done. At any moment there is a certain amount of wealth which can be used to provide more, and therefore a certain amount of work which can be done. What is in the power of those who control that capital is to determine what *kind* of work it shall do, and they will determine that, broadly speaking, by thinking about what sort of things people are likely to want. Upon their decision, which in its turn depends upon the ordinary everyday people's wants, or *demand*, depends the kind and amount of new wealth produced. For instance, a certain amount of capital and work is used in producing strawberries at Christmas time. But when they are eaten they cannot, directly or indirectly, have helped to produce more wealth. No one really needs Christmas strawberries to keep himself efficient. If the capital and work used for the strawberries had been used in building, a house (or part of a house), which could have sheltered some one, would have come into existence, and its existence would have helped that some one to be efficient, and to go on producing wealth. (One of the greatest causes of inefficiency is the want of enough really good houses.)

The *unproductive* use of wealth, for instance growing strawberries in December, is like throwing a small stone against a brick wall. There is a crash and no more. The other, or *productive* use, is more like throwing the same stone into a lake. The circles go on widening and widening for a very long while. This is not really a good simile, because perhaps if we

could hear them the echoes of the crash would go on, and the circles do come to an end. But the idea which is important and interesting is that capital productively used goes on and on increasing, while capital unproductively used comes to an end.

Spending, then, does not make work, but it does settle what sort of work shall be done. And upon that decision will in the end depend the amount of wealth that comes into existence, and therefore to a very great extent the amount of work that can be done next. It is easy to see the importance of all this, and it is a pity that it is not more generally understood. Many good people, really anxious to help, direct spending, the spending of their own money or that of public bodies, in a way which in the end means that less and not more wealth is available for the community. A clear understanding of the importance of all these matters would certainly be a very great help in public life. It needs a good deal of thinking about, but it is one of the questions which concern us all, and which, if we understand it, will make us more valuable as citizens, as well as making our daily life and our own little spendings infinitely more interesting. The economic effect of spending is not the only effect that citizens are called upon to consider, but it is a very important effect, and one which needs a good deal more considering than it generally gets.

IF ALL THE PRODUCTIVE FORCES WERE AS EFFICIENT AS POSSIBLE

NATURE AND MEN

We have been thinking how wealth is produced, and upon what sort of causes the amount of production depends. Let us amuse ourselves briefly by imagining a country in which all the agents of production, Nature's forces, man's work, and capital, are as efficient as possible.

First, Nature will do her best. Our imaginary country will have a temperate climate, cold enough but not too cold in winter, hot enough but not too hot in summer. There will be a sufficient rainfall, and the rain will be obliging enough to come when it is wanted, not, for instance, just in the middle of the harvest. In fact, our own climate, at which we love to grumble, when it is on its very best behaviour, is not so far removed from perfection as we are apt to think. It is wet, but not too wet, and as a rule frost and sun do their work pretty well.

Then this fortunate land must have good harbours, well distributed, well sheltered from the prevailing winds, and good waterways, leading conveniently into the heart of the country. The hills and valleys will be arranged in such a way as to make good roads, whether for trains or other transport, easy to construct, so that every part is easily

accessible, and produce can be moved about in all directions with very little trouble or difficulty. There should be several varieties of soil, so that all kinds of crops can be grown, and there must be hills and sheltered valleys as well as open plains. Lastly, there must be either coal, or else enough water power to make plenty of cheap electricity. Perhaps a sprinkling of other metals, and certainly some iron, would help.

So much for Nature. Now what about Man?

The population of the country will be thoroughly healthy. They will have started with good sound bodies, and will know how to keep them strong and well. They will have plenty of outdoor exercise, games and otherwise, when they are young, and they will have a love of the open air. At this point it seems clear that they must live in a new and not an old country, for they must occupy good dry airy sunny houses, and there must be no slums. Yet there is hardly an old town which has not slums: they seem, indeed, part of the price we pay for age and history. Slums, however, there certainly cannot be, they always mean bad health and inefficiency. The houses will be arranged so as to save all unnecessary labour, and much of the work will be done by electricity.

The towns will be more like our garden cities, planned so as to allow of air and sun for every house, and it is certain that there will be *no smoke.* Somehow or other our fortunate friends will have learnt to deal with the smoke nuisance, and will in consequence save an enormous amount of the capital and labour that we have to spend upon soap, cleaning materials, and the restoration of buildings which crumble away

through the action of the smoke. It is difficult to think of anything which makes more work than dirt, and most of our town dirt is directly due to smoke. Imagine London or Manchester without smoke, and think of the saving in laundry, dusting, scrubbing, cleaning, and painting.

Partly because the people will be so well educated that every one will be able to make the very best of his or her capabilities, and partly because of the absence of restrictions, each person will be doing the work for which he or she is fitted. There will be very few square pegs crushing uncomfortably into round holes. The heavy and disagreeable work will be done mostly by machinery, that is, by Nature's forces harnessed and controlled by man. As every one is doing the work for which he or she is best fitted, and as education will have trained them all to make the very best of their faculties, they will be able to produce great quantities of wealth with what to us might seem remarkably little effort. (Perhaps, if some of our remote ancestors were to come to life again and watch the performances of modern machinery they would think our lives amazingly easy compared to theirs.) Every one will be keen to improve the methods of production, and not only the people whose specially good brains or special powers of foresight have led to their having the direction of work, but also those who are actually doing the work, will be thinking of new and better ways of carrying out the different operations.

And partly because of the highly efficient production, and partly because of the widely-spread habits of saving, there will be plenty of capital

with which to carry out all improvements. Every one and everything will be so efficient that wealth will be abundantly produced, every one will be so well educated (among other things in economics) that there will be no waste. So that the excellent banks and the highly skilled bankers will always have supplies of capital available for inventors, manufacturers, farmers; in short for every one who needs it in order to improve and develop production.

There will clearly be no war, or fear of war, so that the work both of hand and brain, and the valuable material, which we in our own imperfect world have to devote to the military and naval preparations that we believe essential to safety, can all be used for other forms of production.

If there were no wars and no smoke an incalculable amount of work and wealth would be set free to produce more wealth, and our imaginary country would produce all that was strictly speaking necessary to maintain its efficiency with great ease. The rest of its time and its brains and its capital it could devote to the things which may not be essential but are certainly agreeable and worth having, and which have not hitherto been available for every one, though it is worth remembering that practically every one now has access to comforts and luxuries which were not only unheard of but not to be imagined quite a little time ago. For instance, motor omnibuses, electric trams, and chars-a-bancs enable people to move about with ease and speed, the opening up of new countries and the immense improvements in transport have made it possible for

us to have a variety of food all though the year which would certainly have astounded the housekeepers of a hundred years ago. Our methods of production have improved and are improving, though we still have some way to go before we get to the position of our imaginary friends.

DISTRIBUTION

HOW WEALTH IS DIVIDED

FOUR SOURCES OF INCOME

While we have been thinking over the production of wealth, and the various causes which determine the amount that comes into existence, we have said nothing about the other side of it, that is, how is wealth divided among the different kinds of people who make up a nation? As we all know, this is the aspect of the question about which in real life people naturally are very much interested, and which we often hear discussed. But as we said at the beginning, it is no use arguing about how to divide up wealth until we know whether there is going to be any wealth to divide. And in the same way, it is easier to think out, as clearly as we can, the conditions upon which the production of wealth depends, and then go on to find out, if we can, how it is divided. Let us remind ourselves once more that we are first trying to discover what *is*, and *why* it is, so that we may be better able later, as citizens, to see how best we can adjust matters according to what we think *ought* to be.

Now although we are, for the sake of clearness, thinking out first production and then distribution, in actual life they affect each other constantly. If workers of any kind, whether they work with their

hands or their brains, or best of all with as much as possible of both, do not get enough to keep themselves thoroughly efficient, it follows that less wealth will be produced than would otherwise be the case. Or if, again, the owners of capital are discouraged, either by special laws, or by the absence of security, or any other reason, they will be less inclined to save, or even will refuse to save, so that there will be a scarcity of capital, and once again less wealth will be produced. We need, therefore, to be constantly thinking first about the amount produced (a side which is extremely apt to be forgotten), and second, about the methods in which it is shared between the different sets of people in the nation.

In some ways the questions of distribution are harder to work out, because they seem more liable to be affected by the changing of laws and customs. So that, for simplicity's sake it is best first to think of simple conditions, and then to see how far those conditions are true of the country, whichever it may be, with which we are concerned. There are certain things which are true of all modern countries, and other things in which they differ. We try to think first of the things in which they are alike, and then we can add the things in which they differ. We all have the same skeleton but the rest of us is different. A picture of a skeleton would not be a portrait of any one of us, yet, unless a sculptor knows something of the human skeleton, his statues of human beings are not likely to be satisfactory. We will concern ourselves at first with a sort of skeleton which will be true of all modern civilised countries though it will not be the whole of the truth of any of them.

We will take it for granted that people and things can move with absolute freedom about the country, and that there are no laws to prevent them. And we will assume too that buyers wish to buy cheaply, and that sellers wish to sell at as good a price as they can get.

Economists group the people who are going to share the total wealth produced into four classes, according to the reason why they get a share of this wealth.

There are first of all the owners of land or other natural agents, who get *Rent*. These rent-receivers may be individuals, or groups of people like town councils, who represent all the ratepayers of the town, or like the trustees of a hospital or a school; or the Government, which represents all the people of the country. Land in Great Britain, for example, belongs partly to individuals, partly to groups of people, and partly to the state.

Next there are the owners of capital, who get *Interest*. Every one who has money in the Post Office, or in a War Savings Certificate, or a share in the Co-operative Society, is a capitalist, and is paid for the use of his capital by receiving Interest. Thirdly, there are the people who work for payment, with their hands or their brains, or both, and who are paid in *Wages* or *Salaries*—two words for the same thing. And lastly, there are the people who manage and organise the business of production, who use land and capital and employ workers, who sell the things produced, and earn *Profits*, that is the difference between what it costs them to make the things and the price they can get for them.

That is, people get a share of the total product either because they own land, or because they own

capital, or because they use their hands or their brains, or both, to help produce wealth. In real life people may get their incomes because of any one or two or even all of these reasons. Many millions of people now own war bonds of one kind or another, or have money in the Post Office or other savings banks, or shares in a Co-operative Society, and therefore receive interest. Most people receive wages or salaries. A good many, though not so many here as in some countries, own a bit of land. And a good many people are using their powers of planning and organising in order to make profits. We can imagine some one, for example, who has some war savings and some shares in a Co-operative Society, has inherited a few shares in a local concern or a railway, and gets interest upon them, and also owns a little bit of land upon which his house and garden stand. He works at some trade or profession for which he gets wages or salary. And lastly, in his spare time he breeds prize rabbits or poultry, and by his skill in managing them he earns profits. He is one person in flesh and blood, but in our eyes he is a landlord, a capitalist, a wage-earner, and a profit-maker, or manager of business.

We will now try to work out the reasons which determine how much he gets in each of these capacities, or putting it more scientifically, upon what depends the amounts of *Rent, Interest, Wages, and Profits.* Meanwhile we see that once more we, as economists, are using words to mean one special thing, words which are used much more loosely and vaguely in ordinary life. We shall therefore have to be careful in our definitions as we go along.

RENT

WHAT IS IT, AND WHY?

THE very first thing that has to be said about *Rent* is that economists mean one thing, and ordinary people something else, by the word. When we hear people talking in daily life about *Rent*, they usually mean all that they pay for their use of a house, or of a house and land. But to the economist *Rent* means the amount that is paid for the use of the *land* only. The name of a very famous English economist, Ricardo, who lived at the beginning of the nineteenth century, is always associated with the economic theory of rent, and although later thinkers have written pages and pages about his theory, Ricardo was such a clear and logical thinker, that while they have added to it and developed it, they have not really altered it very much.

Ricardo began by imagining how it was that rent came to be paid at all, and after that he proceeded to think out a means of measuring the amount of rents. It is clear that in a new country, or for the matter of that in ancient days, as long as there was any amount of equally convenient land to be had for the taking, no one would be willing to pay anything for the use of land. Rent does not come into existence at this stage of affairs. Let us imagine that a new bit of country is opened

up, and that a group of settlers goes out to cultivate it. Each of them takes possession of as much land as he can conveniently work, and gets it into order.

By-and-by some more people come along, also wanting land. But by the time they get to the settlement, they find that although there is plenty more land to be had, it is not so convenient to work as is the land which the first group occupy. Either it is less easy of access, farther perhaps from the rail-head, or the road, or else it is not so well watered, or it does not get so much sun, or it is farther up the hill and steep, difficult and tiring to work, or the soil is poorer. However, they take possession too, and settle down to farm. We will imagine that they are growing corn (or apples or beef or anything we like). They are farming not only to feed themselves, but for a market. They want to sell their produce. Now the first group of people find that in order to pay their running expenses, to keep themselves, and to allow what is necessary for replacing worn out capital, they must sell their produce at a certain price. The buyers in the market at which they sell are willing to pay this price—let us call it X—and they can make a comfortable living out of their farming.

But what of the second group of settlers? They are not in the same position. Their land, we have supposed, is either less convenient or less fertile. Whatever the exact reason, they find that unless they can sell their produce at a little more than X they cannot make a living out of the business. However, the buyers are quite willing to pay more than X—let us say X plus one—because there is a keen demand

for the produce of this group of farms, corn or apples or whatever we imagine it to be. So the second group of people get *X plus one* for their produce, make a sufficient living by their farming, and are quite happy.

Meanwhile, however, the growers belonging to the first group find that X plus 1 is the price that can be got for their produce, and it is not likely that if they can get X plus 1 they will go on selling at X. So they too get X plus 1. They will therefore be getting for their produce more than the sum at which they would be willing to sell, and still find it worth while to go on farming. The difference between what they are getting, and what they would be willing to take, rather than go out of farming, is due, not to any skill of theirs, but to the fact that they happen to be farming more convenient land. And it is this difference which economists call *Rent.* It need not necessarily be paid away by the farmer to any one else. But as long as there are lands of differing convenience, or productivity, or whatever we like to call it, the more productive lands will have an advantage over the less productive, and the measure of their productivity will be the measure of their economic rent.

We might have gone on with our imaginary settlers, and added several new groups, each taking up land which for one reason or another was less productive, or less convenient, than the land taken up by the earlier groups. Each group of settlers will need to charge a slightly higher price for their produce in order that it may be worth their while to go on farming. But each time they charge a higher price all the other groups of settlers will raise their prices too, for no one

in an ordinary business world is likely to take less than he can get for his produce. If the settlers in group number one find that the settlers in the last new group can get X plus 5, let us say, then X plus 5 will be the market price, and all the farmers will charge X plus 5 for their produce. But as a result all the earlier groups will be getting, not only the amount that they need in order to make it worth while for them to go on farming, but also a *Rent*, varying in amount with the productivity or convenience of their land, but due, not to any effort or skill of the farmers, but to the quality or position of the land they work.

This process can go on until the market, that is the customers, refuse to pay any more. Their demand is satisfied, they would rather not have any more if the price is going to be any higher. They can do very well with what is produced now, they will pay the price necessary to induce farmers to produce that quantity, but no more. So when that point is reached, there will be one group of farmers, the last who arrived, making just what they need in order to induce them to go on farming, and all the other groups making that and something over and above that, and the something is *Rent*. The amount of rent that each group will get will vary with the convenience and productivity of each group of farms, the first, which we imagined to be the best, getting most, and the last but one getting least. Economists call land which it is just worth while to farm at the existing market price, but which could not be farmed if prices went any lower, *marginal* land, and this land can clearly pay no rent.

If we want to go on and make our imaginary groups a little more like things as we know them here to-day,

we can easily do it. Let us suppose that one of the group-one farmers gives up farming, or dies, and that his son who succeeds him does not at all like farming, but wants to study medicine, or engineering. He finds some one belonging, shall we say, to the last group, who is hesitating about whether he will cultivate a *marginal* farm. It is worth his while to do so, but he is newly married, and the marginal farms are a long way out, and his wife will be lonely. The new owner of the first-group farm offers him his farm, but says that he must pay rent for it, the amount of the rent to be the difference between the price at which the produce can be sold, and what it costs to produce it, allowing for everything. The man is willing to pay this rent, he will be just as well off as if he were cultivating marginal land and paying no rent, and his wife will have the advantage of neighbours, or of being near the rail-head, or the shops, or whatever it is that helps to make this farm more convenient than the marginal farm. Meanwhile the owner of the first-group farm can go off and work at his engineering, living meanwhile upon his rent.

THE THEORY OF RENT: SOME ILLUSTRATIONS

Now all this is artificially simplified, and in real life there are many complications. Nevertheless, the essential truth that we have worked out by means of making it very simple remains the same. At any moment, the price of any agricultural produce will be the price which is enough to pay the cost of production upon the least productive land used for that

kind of crop, including the carriage to market, and the rate of profit which is enough to induce the farmer to go on farming. It cannot be less than this, otherwise the quantity required cannot be produced, and it will not be more, because, if it were, fresh land would be taken into cultivation, land which is less productive or less convenient (because naturally the best land would be used first) and upon which produce can be raised at the market price. But as long as there is only one price for produce, and there are lands of differing degrees of productivity, the more productive lands will produce rent, and the amount of the rent will be the difference between the productivity of the piece of land in question, and that of the last land which it is worth while to cultivate at the prevailing price, land on the *margin of cultivation.*

One of the things people usually find puzzling when they begin to think about this economic doctrine of rent, is the idea of *no-rent-land,* land which can be cultivated without the cultivators being obliged to pay any rent for it. But as a matter of fact in old countries no-rent land generally exists, not in whole farms, but in odd fields or patches of land on a farm. Many a farmer has one or two fields or parts of a field on his farm, which it is only just worth his while to cultivate. If his landlord did not throw in those fields with the rest of the farm it would make no difference to the rent. They are not worth paying for. Again, the amount paid by a farmer to his landlord in this country includes a certain amount of *Interest* on capital. His rent includes what he pays for his house, and for his farm buildings. He calls this rent, but it is really

interest. The owner of the land has put capital into his farm, and upon this capital he will be paid interest. In bad times it may easily happen that the amounts paid by some farmers are only just enough or even not enough to pay interest upon the capital sunk in their farms, and leave nothing over for true rent.

Only a very small proportion, as a rule, of what is paid for the use of a town house is really rent, most of it is what is paid for the house, and only what is called the *ground rent*, that is the payment for the actual land upon which the house stands, is economic rent. People are, as a rule, willing to pay very high ground rents for land near the centre of a town, because of its convenience, or the saving of time in moving things to market. These ground rents are a good example of the sort of thing which we have been imagining. The larger the town grows, the more valuable, because the more easy of access, or convenient, will be the land nearer the centre of the town, and the higher will be the rent which people will gladly pay for the use of this convenient land.

We can put all this in another way, and surprise most of our friends, by saying that *rent does not enter into price*. Most people, of course, are quite certain that rent does enter into price, and that high rents make high prices. We, however, saw in our imaginary story that as long as the price of their produce was only X, no one in our settlement paid any rent. It was not until prices rose beyond X that rents came into existence. As we saw then, it was because prices were high that rents could be paid, not because rents were paid that prices were high.

We shall be able to discuss the question of prices later

on, but meanwhile it seems clear that what determined price was, on the one hand, what people were willing to pay rather than go without the article in question, and on the other, what it cost to produce the crop on the least convenient land that at the current price could be used for that crop, or, as the economists say, the cost of production upon land on the margin of cultivation. Now, whoever gets the rent, rent comes into existence as soon as two pieces of land, of varying convenience, are used for the production of the same kind of crop meant for the same market; and whatever happens to the rent, only one price will be charged for the crop in question as long as people are willing to buy it at that price.

We can easily prove the truth of the saying that rent does not determine price by trying to think what would happen to prices if rents suddenly vanished. Let us suppose that some one is about to open a shop, (let us have a change from crops.) He has the choice of two, each equally good as regards buildings and fitments, but one is in a side street, and the other in a main thoroughfare near the middle of the town. The owners demand a very much higher rent for this one. Which shall he take? Let us suppose he decides to take the dearer. He expects to be able to pay the higher rent in one of two ways. Either the superior position of this shop will enable him to get at people who are willing to pay high prices for what they buy rather than go out of their way to look for cheaper things—busy people or rich people. Or else, because it is on a main road, he will be able to sell many more articles, and though he will not charge a higher price for them he will make more altogether, because his

'turnover' will be so much larger. Anyhow, he knows what price he can expect to get for whatever it is he means to sell, and he reckons that the superior position of the expensive shop makes it well worth his while to pay the extra rent for it.

Let us, for example, imagine that he means to sell boots. The people who shop in the fashionable street are ready to pay a high price for their boots: those who cannot afford expensive boots go and shop in more modest quarters. Or let us imagine that he is a tobacconist. He hopes by having a shop in the main thoroughfare to sell so many packets of cigarettes and tins of tobacco, to those who are obliged to pass his doors that again he can afford to pay the high rent.

Now, suppose he wakes up one fine day like people in story books, to find that a rich and unknown relative has died, and has left him the freehold of his shop. He will no longer have to pay any rent. Will he lower his prices? Not a bit of it. Why should he? His customers are willing to pay the price: if he could have done a more profitable business at a lower price he would have lowered the price already. He is working at the price which pays him best anyhow, and he will continue to sell at that price. He will be a richer man than before no doubt, but it will be because he has become a landlord and a rent owner as well as a shopkeeper. But whatever else he may do with it, he will not make his customers a present of his rent. That is, not if he is an ordinary business man, living in the ordinary business world about which we are thinking and reasoning. So that once more we see that rent, that is economic rent, does not enter into price.

THE LAW OF DIMINISHING RETURNS

Ricardo, contemplating the operations of the farmers in his day, and thinking over the theory of rent, was led to some depressing conclusions. He saw that there were only two ways in which to increase the amount of agricultural produce. One was to take in fresh and hitherto uncultivated land, but that process would necessarily come to an end when all the available land had been used up. When that happened, what man had to do was to *intensify* his production, that is, by putting in more work and more manure to get more produce out of his soil. But Ricardo realised, what indeed most of us who have tried our hands at gardening or farming operations have usually discovered to our cost, that there comes a point at which this ceases to pay. After a certain time, when one has arrived at a certain stage in cultivating, each addition to the labour and capital that one puts into one's land brings in a less and less return until one comes to the point when it brings in no return at all. This is what economists call the *law of diminishing returns*.

Thinking over this law, Ricardo was forced to conclude that the prices of agricultural produce would go on and on increasing, until they were so high that people would no longer buy, and would either leave the country in search of lands where living cost less, or else would be unable to marry and have families. In either case the population would cease to grow, and the demand for agricultural produce would no longer increase.

Now we must remember that Ricardo was living in times not so very unlike our own, at the end of the Napoleonic wars, and that during the war he had seen with his own eyes worse and worse land going under the plough, and corn being grown upon what was indeed the margin of cultivation. The price, as we should expect, had risen tremendously high, and it had been very difficult to get any corn in from Europe. We have seen the same sort of thing happening, though not to so great an extent, during the great war of our own times, when owing to the submarines we had to grow as much corn as we could at home, instead of getting it from abroad.

But what Ricardo did not allow for, at least did not allow enough for, was man's ingenuity. The law of diminishing returns is indeed true, and does constantly threaten mankind with rising prices of agricultural produce. But whenever man begins to feel rather uncomfortable, owing to the operations of this law, he turns his brains to work and tries to think of a way of dodging it. Hitherto he has done pretty well, indeed from one point of view we could describe all economic history as a long struggle between man and the law of diminishing returns, in which so far man has had the upper hand. He discovers new methods of cultivation, new rotations of crops, new ways of applying his knowledge of chemistry to agricultural operations.

The way he evaded it just after Ricardo's day was by the development of steam transport and the opening up of the new worlds of North America and the Argentine, which have fed us successfully ever since. It looks as if agricultural chemistry were going to

solve the problem for us in the immediate future, but it is rash to prophesy. All we can say is that whenever the price of food becomes, or looks as if it were going to become, permanently and uncomfortably high, man sets his wits to work and finds out a way to bring it down again. And so far he has succeeded in keeping himself comfortably fed.

However ingenious man may be, it does seem as if the growth of population must necessarily mean an increase in rents. The more people there are to crowd upon the earth's surface, the more valuable pieces of that surface must become, and the more will people be willing to pay for the use of specially convenient pieces. Now a great many people feel that this increase in rents, which is due to no special skill or wisdom on the part of the owners of the land, ought to go not to individuals but to the community, in one form or another. It is a large and difficult question, and not one which can be discussed here, indeed there are volumes and volumes already existing which deal with it. But it is just worth while saying that the owner of agricultural lands, if he knows his business, renders a very real service to the community, for which the rent he receives may be taken as the payment.

It is certainly to the interest of the community that land should be used in the most productive way that is possible, and that the methods of cultivation should be the very best. Now, human nature being what it actually is, and not what speakers and writers and even economists assume, it is possible that if a man occupied very good land, and did not have to pay the economic rent for it, he might not take the trouble to get the most out of that land.

Let us go back to our imaginary friends the settlers, and let us suppose that there are about six sets of them and that the price of produce is therefore X plus 5. Now the first set could make a very comfortable living when the price was only X. There is, therefore, to say the least, a chance that the first set, or some of them, will be tempted not to do the very best by their land, but to grow about as much as will enable them to maintain themselves comfortably, with perhaps a little over. Now their land, if it is properly worked, will, as we know, do a great deal more than this, and it is all to the advantage of the world that it should be made to do what it can. Therefore we may say that a landlord who knows his business, who keeps his farm buildings in proper condition, and by the careful selection of tenants does his best to ensure that his land is made to grow as much as it possibly can, is well earning his rent.

It is said that the highest rented districts are as a rule those where farming is best, and that in the districts where rents are below the economic rent, one may find a farm here and there cultivated as highly as possible, but that the general level of cultivation will be below the level it could attain. Many of those who know most about farming, in this country at all events, hold that a landlord who knows his business and does it efficiently is anything but a social debtor.

Whatever we may think about the uses of landlords, urban or rural, and it is a question about which there is room for every shade of opinion, we have now worked out for ourselves the nature of economic rent; the laws which determine its amount; and the law of

diminishing returns, with its relation to these matters. We must remember, when we try to apply this reasoning to the questions of to-day, that land which is 'marginal' for one use may be very valuable for another, and that therefore marginal land is not a fixed quantity. For example, dry gravelly land, which is remarkably bad for farming, is perfect for the site of dwelling houses, and although it would be an excellent example of No-Rent land from the farming point of view, it might easily command a high rent if the growth of a town made it suitable for building sites.

If all land were let on strictly business principles, rent could never be *higher* ~~than the 'economic'~~ rent, because no one would be willing to pay more than the difference between the productivity of the land he was using and the land which was at the time 'marginal' for that purpose. Nor would it go below, because the owner of the land could always find some one who wanted to use that land and would be willing to pay for its use. The rents of building sites in towns are, as a general rule, regulated by strictly business principles, and town ground-rents therefore more or less correspond with the economic rent. In the country, however, many other influences come in—sentiment, tradition, family feelings—and agricultural rents are very often below the economic limit.

INTEREST

WHAT IS IT, AND WHY IS IT PAID

WE saw that one of the things necessary for the production of wealth is that there should be a margin between what is produced, and what is immediately consumed, and, also, that the wealth which was not used up at once should be used as *capital*, that is, used to produce more wealth. Interest is the price paid for the use of capital, and what we have to consider is first, why people are willing to pay it, and secondly, what settles how much they will have to pay.

First, then, people are willing to pay for the use of capital, because by using it they increase their wealth. As we have already discovered, when capital is used it not only produces the same amount of wealth as was 'consumed' in the process of using it, but something over and above that amount. Our early man sowed only a few measures of corn, and reaped, when harvest time came, many times as much as he had sown. People who possess capital, to put it the other way round, are justified in making a charge for its use if they lend it, because if they did not lend it, but used it themselves, they would have in the end not only the original amount, but that amount and something more. How much the something more would be must depend on many things, but as there would *be*

something more if they kept their capital for their own use, they can well say to the person who wants to borrow it from them, 'By all means, but you will pay me back in time, and you will pay me back not only just what I am lending you, but more, because my loan will enable you to increase your wealth.'

As most people know, this idea of the *productivity* of capital was not fully understood in the Middle Ages, and lenders were forbidden to charge for the use of their capital. As time went on, it became clearer that it was desirable not only to allow the payment of interest, but almost to encourage it, in order to encourage the accumulation of capital, and thus to encourage also the production of wealth. But in old days a good deal of borrowing was done, not for productive purposes, but perhaps to carry on wars, or for other purposes unlikely to lead to the production of wealth, and as those who could lend were very uncertain if they would ever get their loans repaid, they were apt to charge exorbitant prices, and thus make themselves extremely unpopular. People who borrow in order to get themselves out of difficulties are always likely to be in a different, and a worse position, than people who borrow for economic reasons, that is in order to produce. However, we need not now concern ourselves with mediæval ideas, and we can go on to discover what determines the amount that borrowers will have to pay for the use of capital, that is, on what does the rate of interest depend?

The interest that is actually paid depends on two things; first, the actual rate of interest pure and

simple, and secondly, an allowance for risk. Thus we shall find that there is always what we can call a 'market rate' of interest, and that some borrowers will have only to pay this, some rather more, and some a good deal more. The difference will depend upon how far the lender feels certain of getting his capital back again. Borrowers who can offer perfectly good 'security,' and borrowers who can only give a doubtful security will naturally be in different positions. So that the rate of interest which any borrower will pay will consist of two elements, one pure interest, and the other insurance against risk. In Great Britain, for example, the Government, or for that matter the London County Council, or the Council of any big town, can borrow at a much lower rate of interest than can most business firms. This is because they can offer something very like perfect security, and there are always a good many people who would rather take a low rate of interest and feel that their savings were absolutely safe, than a higher rate and not be perfectly sure of being repaid in the end.

Apart from risk then, what settles the rate of real interest, that is the pure payment for the use of the loan? The rate of interest at any moment will depend upon two things. The first is the amount of capital which can be lent, and the willingness of its owners to lend it, and the second is the number of enterprises which at the moment are needing capital for their development, and how productive those enterprises are likely to be. To put it shortly, interest at any moment depends upon the *demand* for, and the *supply* of loanable capital at that moment.

THE DEMAND FOR CAPITAL WHICH CAN BE LENT

Let us look at it first from the point of view of the borrower, and let us for simplicity's sake think of that borrower as a person who is engaged in production, and who will decide whether or not he will borrow according to whether or not he thinks it will pay him to do so.

Let us imagine that he has a factory and produces buttons, or boots, or anything else we like to imagine. He knows what rate of wages he has to pay, and about how much his workers will turn out, he knows too what price he can get for his goods. There is a new machine which he has seen and which he would very much like to possess. Shall he borrow a thousand pounds and buy one? He makes long and careful calculations. The use of the machine would enable him to turn out more boots, or buttons, at a lower price each. He can produce more, and the cost of production of each will be less. Out of this lowered cost and increased amount he must be able to put aside a certain amount every year in order to provide for keeping the machine in repair and for the repayment of the loan. When he has done this, and allowed for his ordinary expenses, he finds that he ought still to have something over, if all goes well. Let us say that he thinks he will have about eight to ten per cent. more. Therefore it will pay him to borrow if he can get the capital for eight or nine per cent, or less, but if he has to pay more the new machine will not be bought.

In other words, the use of capital in industry is to

enable producers to employ methods of production which result in increased wealth. Such new wealth may take some time to come into existence, but there is more of it in the end. Out of the increased product must come what has to be paid to the workers, what the producer himself must have in order to make it worth his while to go on producing, the necessary allowances for insurance against risk, the replacement of the capital itself. What is left, over and above all this, is available for the payment of interest.

But will the producer actually have to pay away all that he could pay, and would indeed be willing to pay in order to have the use of the capital? This will depend upon the other party to the affair, that is the lender. What are the influences which affect lenders?

THE SUPPLY OF CAPITAL

The owner of capital can take one of several courses. Either he can go into production himself, or he can lend, or he can use his capital not in production but to amuse himself. Which he will do will probably depend upon many things, among others his nationality, his tastes, his habits, whether he looks forward or thinks of the present. But among the things which will influence him will be the amount he can get for the use of his capital. A high rate of interest tempts the most improvident of people to save, and when interest is very low there are always a certain number who think it better to enjoy their wealth now than to save it, when the amount they can get by saving is so small.

There are also a number of people who are determined to save, for their children, or to provide for their own old age, or for illness or unemployment, and these will save whether interest be high or low. Indeed, we might think that some of them will have to save more when interest is low than when it is high, that is if they wish to save enough to bring in a definite income. It is interesting to speculate about how much of the savings that are actually made every year are due to reasons of this kind. However this may be, it seems true that as the rate of interest rises, the amount of loanable capital increases, that a high rate does produce an increased amount.

Now, to return for a moment to the borrowers, it is probable that at any time there will be enterprises of varying degrees of productivity needing capital for development. Some of these, possibly such as are due to new inventions or discoveries, may seem likely to be very productive, and the people who manage them can and will pay a very high rate of interest, rather than not get the capital they want. Others can only pay a moderate rate, and will not borrow unless they can get capital at a low rate. At any moment there are a number of people wanting to borrow, and willing to pay varying amounts, and a number of people wanting to lend. The actual rate of interest then at any moment must be that at which all the capital which will be lent at that rate *can* be borrowed.

Let us suppose the rate is 5 per cent. Every one who is willing to pay 5 per cent. can get capital. Some would pay more rather than go without, but no one will pay more if he can get it

at 5 per cent. Suppose there are not enough businesses willing and able to pay 5 per cent. to use up the amount of capital which owners want to lend. Then the owners of that part of the capital which has not yet been borrowed will have to make up their minds whether they are willing to take less rather than not lend at all. They think it over and decide that they will take 4½. There are several people who will gladly borrow at 4½ who could not come forward as long as the rate was 5. So the available supply is all used up and all the lenders have lent.

But meanwhile the people who have paid 5 will discover that capital was to be had at 4½. This will make them very unwilling to pay 5, and they will try to make a new arrangement. Moreover, they will succeed, because the owners know that if their borrowers repay them, they will not be able to find other borrowers who will pay more than 4½. So that the actual rate of interest at any moment will always be that at which all the capital available at that rate can be used. Those lenders who are unwilling to lend at the market rate, but want more, will not be able to lend; those borrowers who cannot afford the market rate will not be able to borrow.

A high rate of interest may thus be due either to conditions of great activity and productivity, when much capital is wanted, and people are able and willing to pay a good deal for its use, or it may be due to periods of great scarcity, for instance, to the effects of war. Similarly a very low rate of interest may be due to a lack of business, stagnation of trade, when no one wants any capital, or it may be the result of

great productivity which has led to an increase of wealth and an abundance of loanable capital.

Broadly speaking, there are always two sets of forces at work, and they bring about a sort of balance. There are all the forces which lead to a demand for capital, and all the forces which lead to its accumulation. The rate of interest at any moment will represent the level which is at that moment attained. A low rate of interest, in so far as it tends to check saving, and to encourage borrowing, sets to work forces which may lead to a rise in the rate. And similarly a high rate, which stimulates saving, and acts rather as a check upon borrowing, sets to work forces which in due time will tend to lower the rate. Which of these two sets of forces will in time prove the stronger it is hard to say Man's skill, and his increasing command over the powers of nature, with the resulting great increases of wealth, would in the end seem likely to lower the rate of interest. But, on the other hand, wars and other destructive forces help to keep it high.

It is interesting to think out the different causes of high and low rates of interest. New discoveries, and the opening up of fresh countries will raise it for the time being by increasing the demand for loanable capital. But after a time the result of discoveries and the development of the new land will have produced fresh supplies of wealth, increased the amount of loanable capital, and the rate will fall. A rate which is low enough to enable production to be carried on in the best possible way, and yet not so low as to check the rate of accumulation, is clearly what would be the best for a community.

WAGES

PAYMENT FOR WORK

Of all economic problems that of the theory of *Wages* is at once one of the most difficult, and one of the most interesting. It is of the greatest interest, because upon the right understanding of wages largely depends the livelihood of millions and the prosperity of every one. And it is of the greatest difficulty because here almost more than anywhere else all the feelings and passions and prejudices and traditions and sentiments, not to speak of all the changes in law and custom, which we can ignore or take for granted in many economic discussions, have constantly to be considered.

There are many people who object to the very idea and the very word. They do not believe that any person, or body of persons, ought to employ other people, and pay them wages for the work they do. And it is true that under the wages system, as indeed under pretty well any other system worked by human beings, subject as they are to human sin and weakness, there has been much trouble and suffering. But, however we feel about this, we must agree that there are always a certain number of people, in any society, who are good workers, but who have not those special qualities of character which make men or women good leaders of others, or those qualities of brain which

make people able to direct industrial processes, foresee the future, plan out complicated economic or business transactions. Equally, of course, there are people with remarkable intellectual gifts, whose work may be of the greatest possible benefit to mankind, but who are almost unbelievably incompetent with their hands and as helpless as a child in the affairs of everyday life.

There is room for all kinds of people in the world, people who have the gift of direction and like responsibility, people who like regular work and do not want to think too much, or who would prefer to follow rather than to lead. What is of tremendous importance, if we are all to live happily together and make the most of our life in this world, is that people of all these differing kinds should do the work, whatever it be, for which they are really fitted, and not make themselves and every one else uncomfortable by being in a position for which they are not really fit, whether that position is one for which they are, as people say, too good, or one for which they are not good enough. And whether the wages system as we have known it, or some other, is in force, there will probably be people who work, people who direct, people who plan, people who carry out the plans made by others, and much trouble will be saved if we can understand at least broadly what they can expect to get from the wealth that is produced in return for the different kinds of functions they perform.

We may not be able to decide exactly what ought to be the share of the actual workers, indeed it is no part of our business as economists to do so. But we can see what is the limit above which and below

which the share of the worker cannot go, without injury to production. If we really can understand that, we shall be in a better position to make up our minds, as citizens, about laws or customs which affect wages. We may in this, as in other economic questions, think that it is worth while to do something which means an economic loss for the sake of a political or social gain. But it is clear that we shall be better able to judge if we have some idea of what the economic loss may be, and to what results it may lead.

In early days this problem would not arise. Our friends who used flint weapons, or even those who lived centuries later, would have been their own landlords, their own capitalists, their own business managers, and done their own work. And a hard time in those days they had, and very little result for all their labours. Gradually, as time went on, people began to divide themselves up, and those who had the qualities, whatever they may be, which lead men to control the lives and work of others, took the lead. Through war, through trade, in many different ways, there came to be, as we all know, men who worked by taking risks and responsibilities, controlling the work of others, and men who worked for a given wage, and took none of those responsibilities.

The development of machinery made this process, which had gone on slowly through the ages in varying ways, as our history books tell us, go on a good deal quicker, and it also seemed to sharpen the distinction between those who were employed and those who employed others, paying them for the use of their work. So that the idea worked out by the economists

is that as the landlord is paid by rent for the use of his land, the capitalist by interest for the use of his capital, the labourer or worker is paid by wages for the use of his work, and the business manager or employer is the man who uses them all, pays them all, and makes what he can for himself out of it. What we have now to discover is how the amount paid for the use of *work* is determined.

EARLY VIEWS ABOUT WAGES: THE WAGE-FUND THEORY, THE WORK-FUND THEORY, THE PRODUCT THEORY.

In the middle of the nineteenth century the views held by thinkers were of a depressing character. They saw something which was no doubt true, but which was not the whole of the truth, and the theory of wages set forth by John Stuart Mill, one of the very greatest of English thinkers and economists, is anything but encouraging. Before he died he had changed it to a great extent, but in his book, *The Principles of Political Economy*, which is one of the classical works on economics, and very widely read, it is set forth on the old lines.

Unfortunately, not every one who reads Mill knows in what directions thought has developed since his day, and so there are people who believe that his theory of wages is to be accepted. This has had unfortunate results, partly by making people think that it is no use trying to improve conditions as long as we have wages at all, and that the only way to improve is to sweep away the existing system; and partly by discouraging people who were genuinely

anxious to make improvements, and were, or would have been, able to do so. We should not need to trouble about it ourselves, for it is no longer accepted by thinkers, but as it has had so much effect, and has been so widely known, it is worth while to learn what it was.

Putting it very shortly, this theory, known as the *Wage Fund Theory*, says that wages are paid out of capital, that at any given moment there is a certain amount of capital out of which they can be paid and no more. The result is that if one set of men get more, another must get less, and a more depressing notion could hardly exist.

We must think about the conditions of the times in which Mill lived, and if we do this we shall see that his views are, as is usually the case, a reflection of what he actually beheld. There was a great scarcity of capital, largely due to the immense development of steam transport, and a good many people wanting work. The modern organisations with which we are so familiar, from the great Trades Unions to unemployment pay and labour exchanges, had scarcely come into being. What capital did exist was badly wanted for such work as the building of railways and the laying down of railway lines, and there was something like a shortage of 'circulating capital' available for the support of the workers, in other words for the payment of wages.

We can now see that neither of the two statements which make up the wages fund theory is wholly true. It is not true, in the first place, that there is in any country, at any time, a certain amount of capital which will definitely be used for the payment of wages. There may be a certain amount of capital which

can be used for the payment of wages, but whether it *will* be so used depends upon a number of circumstances. Neither is it true that there is in any country at any time a definite number of workers who must take work whatever be the rate of wages. We all know that this statement does not correspond with facts. But we can well understand that as long as those views were held it would be natural for people to think a great deal about the importance of emigration, or of the forces which are likely to check the growth of population. The fewer people there were, the more it seemed there would be for those that were left. And also those who accepted the wage fund theory could not but believe that those Trade Unions which succeeded in getting higher wages for their members were taking away the share of some one else. Altogether a depressing idea and one of those which made people fifty years or so ago talk about political economy as 'the dismal science.'

Fortunately, we need no longer distress ourselves by accepting it. But there are, it seems, still many people who have in their minds a new variation of this theory. They apparently think, not so much that there is a certain amount of capital to be divided up among the workers, but that there is a certain amount of work to go round, and that the more one man does the less there will be for every one else. This view is no nearer the truth than the other, indeed it is if anything further. Carried out to the end, it looks as if the less each of us did the more there would be for every one, which is clearly absurd. As so often happens, it seems plausible enough, taking short views, and many people do not get beyond

taking short views. But when we come to reason it out we see the fallacy.

Suppose there is a house to be built. The bricklayer knows how many bricks will be wanted. He says (taking the short view), 'If I only lay so many a day there will be work for two or three of us for three months. If I lay more there will perhaps be only work for me and one other man for part of the time.' So he only lays half or a third as many bricks as he could lay, without tiring himself too much, and this not in the least from laziness, but from a wish to divide up work among as many as possible.

What is the result in the long run? If three bricklayers have to be employed to do the work which one, or one and a half, could have done, the brick part of the house will cost three times, or one and a half times, as much as it need. Houses will not be cheap. Therefore people will not be able to afford so much house-room as they would otherwise have done (or if they do they will have to go without something else). The next result will be a diminished demand for houses. Fewer houses, or smaller and therefore cheaper houses, will be required. That means in the long run, and perhaps not so very long a run either, less work for bricklayers. So that the probable result of spreading the work out thin in the first place is less work in the second. Moreover, the rest of the population suffers from having to pay more than is really necessary for housing accommodation.

But if we are to accept neither the Wage-Fund Theory nor the Work-Fund Theory, what can we accept?

As a reaction from the wage-fund theory, some economists next proceeded to work out what has been

known as the *Product Theory* of wages. They were partly influenced by conditions prevailing in the United States somewhere about the seventies of the last century. They said: Wages are not paid out of capital, they are paid out of the product of labour. For instance, the American farm labourer does not get a monthly wage, he gets a lump sum at the end of the harvest; clearly he is paid out of the product and not out of capital at all.

As most wages are still paid weekly or monthly, in many cases long before the product has come into existence, and certainly before it has been marketed, this view will not do either, and we need not spend more time over it. Like its predecessors, it represents one aspect of the truth, that is that wages do to a great extent depend upon product, but it does not contain the whole of the truth. What then does determine the current rate of wages in any trade at any time?

MODERN VIEWS: DEMAND AND SUPPLY

Wages depend upon the *demand for and the supply of* labour, and what we have to discover, if we can, are the various forces which determine this demand and supply.

(a) Demand

The demand for labour at any time must clearly be limited, as the wage-fund people saw, by the amount of capital which at that moment can be used for the employment of labour. But one great difference between our view and theirs is that while they thought of this amount of capital as a fund, we think of it

rather as a stream, constantly flowing, and not necessarily of the same size from one moment to another. What determines the size of the stream? The efficiency or productivity of labour itself. This is where the Product Theory people were right; they saw that the product of labour must be closely connected with the amount which could be paid in wages. What they forgot was that workers cannot always wait till the product is obtained, and that therefore wages must be *advanced* out of capital.

We are now a good deal further on. We see that at any moment there is a certain amount of capital which *can* be used for the payment of wages, that the size of this amount depends upon the productivity of past labour, and that whether the whole of it will or will not go to pay wages depends mainly upon how far labour is expected to be efficient, or productive, or whatever word we like to use, in the immediate future. That is, the *demand* for labour is for the moment limited by the wage fund, or better wage flow, but the size or amount of that flow is the result of past labour, and its fate, that is whether or not it will all go to future labour, depends largely upon the expected productivity of future labour. If bargaining power between the business manager and his workers were absolutely equal, the worker would therefore get the whole of that part of the total production of wealth which was due to his own efficiency. If he got more, he would have some part of what was due to one or other of the other agents of production; if he got less, it would be because his bargaining power was unequal to theirs.

Let us put the thing in a rather more definite manner

by way of illustration. Let us imagine some one who is going to produce flower pots, or boots, or whatever we please. The some one is a business man, who is trained in business methods, and has good business abilities. He has taken a piece of land, for which he pays rent. The land is, he thinks, worth what he is going to pay, it is within easy reach of the railway, and of the neighbouring small town, where he hopes to find his workers. He borrows his capital, with it erects his factory, and puts in the necessary machinery. For his capital he has to pay interest, and also he must put aside a certain amount each year to provide for repairs and for repayment within a given time. Now he has also to employ labour. How will he decide how much he shall pay his workers? (We are still thinking of this question from the demand side; we shall come to the other, the side of supply, in due time.)

We are taking it for granted that he is a good business man and no fool. The first thing he will feel is that he must pay his workers the amount, whatever it is, which is enough to keep them as efficient as they can possibly be. It cannot pay to put wages below the point at which the workers are thoroughly efficient. That will be his downward limit; below it he will not go. But if his business is very successful, the demand for his flower pots or boots good, and his workers keen, the conditions under which they work satisfactory, and everything goes well, the result of their work and his management may be an amount which, after it has given him enough to make him feel that it is worth while to go on managing, leaves something over. That is, the product may be large enough to pay his workers efficiency wages, to give

him the necessary amount of profit to keep him efficient too, and yet there may be something over.

Now who will get that, or in what way will it be divided between him and his workers? It is impossible to say, for the exact division must depend upon many circumstances. But we can point out the upward limit beyond which wages cannot go. They cannot go beyond the point at which the article in question can go on being not only produced, but sold for a sum sufficient to cover all the expenses of production. Suppose the workers are in one way or another enabled to get the whole of this surplus, that is the amount which is over when both they and the business manager have had the sum which is enough to keep them perfectly efficient, and after rent and interest have been paid. Nothing will happen. But suppose they are not content, and try to push wages further up still. Then things will begin to happen.

In the first place, can the extra amount the workers want over and above the surplus come off interest? Not in an ordinary world such as we know, because the owners of the capital available can get the amount paid, that is the market rate of interest, from some one else, if not from our friend, and at less than the market rate of the moment he cannot borrow, for they will not lend. Nor can it come off rent, because if he will not pay the economic rent some one else will, and why should the owner let him have the land for less? Can it come out of his own share, profits? Possibly it might for a little time, if he thinks he cannot do better elsewhere. But we have assumed him to be a competent, well-trained man, and he can get what he needs elsewhere if

he cannot get it here. In any case if he takes less than what he needs for long his efficiency will begin to get less, he will make mistakes, get worried, and be unable to make up his mind quickly, or in some of the many possible ways be less efficient.

Then can the increased amount come out of the buyers, that is, can it go on to price? This again depends upon a number of varying conditions, but the answer is that in ordinary circumstances it cannot. For in every business there are many competitors, some within the country, some in other lands, and if the price of boots or flower pots or anything else is forced up in one district, or one factory, or one country, beyond the current market price, buyers will fall off. Either they will try to buy elsewhere, or else they will try to do without. In either case demand will grow less, and that means that fewer people will be employed in the business. If the workers require more for their labour than it is economically worth, unemployment is bound to follow.

Of course, this does not mean that wages cannot rise. On the contrary, they can and do, and let us hope, will. In the first place there is the question of the amount that is over after all the different agents of production have been paid what is necessary to make them as efficient as possible. There is often a very considerable surplus, and upon the bargaining power of the workers depends how much they get of this. And then the efficiency of labour, that is of the workers, is no more fixed than is the wages fund, on the contrary it is, and well may be, perpetually increasing. Education, character, all the many factors of efficiency which we discussed early in this book,

can be improved, and the more efficient the workers in any trade or profession or country become, the larger is the amount of wealth produced, and the larger the share of the total available for the payment of labour.

From the point of view of *demand*, then, we can fairly say that wages depend upon the productivity of labour, that is, in so far as business conditions prevail, and the bargaining power of all the various agents of production, which means their knowledge and their power of moving freely about, are equal.

(*b*) *Supply.*

Now what about *supply*? The supply of labour for any industry at any particular time means the number of people who can work at that industry, and who are willing to do so at the rate of wages offered. The actual number must depend upon the population, and whether or no there are any laws or customs which prevent any one who wishes to do any special work from doing that particular work. As most of us know, there are in some trades rules which limit the number of apprentices who may be taken, and this means that the number of people who can actually work at the trade because they have been trained for it is limited.

Sometimes the supply of workers in any particular place is accidentally limited by a shortage of houses. But in the ordinary way that sort of difficulty would only be temporary, for if a new industry sprang up in some village or small town, and proved so attractive that people from other neighbourhoods wanted to live in that place in order to work in the industry, the local builders would soon turn to and build

them houses. And if there were not enough local builders others would move in from other districts, and gradually the supply of houses would become equal to the demand for them.

The apprenticeship rules, too, can always be changed to suit changing conditions, and if any industry which had strict rules of apprenticeship discovered that there were really not enough workers to do the work required, they would make changes in the rules. So that, although the number of people who can work at any trade or profession may be insufficient for a time, owing to causes of this kind, in a modern world, where people easily move, the shortage is not likely to last for very long, that is, not for many years.

But the actual number of people who can work at any trade or profession is not the only factor in supply. We must also consider their willingness to do that kind of work, or to accept the current wage. There are some kinds of work which are so unattractive that, although people can make a very good living out of them, there are not enough workers to do what is required. Fortunately there are all sorts of people in the world, and some like what others hate, so that it is a very unattractive job which finds no one to do it. People's tastes, however, change from one generation to another, and in the last half-century or so we have seen an increase in the number of people who apparently do not mind smoke and noise and dirt and crowds, and do like theatres and cinemas and the society of many other human beings of varying types. Perhaps there will be another change by-and-by, and we shall get the new generation longing for peace and beauty and quiet and close contact with

nature, and then there will be more people available for the kinds of work which can be done in the country, and fewer for the kinds that are done in towns. Just now there are rather too many, as a rule, available to do town work, and not quite enough for country jobs.

Supposing next that there are people who can do the work, and are willing to do it, we have to consider whether they will do it at the current rate of pay. This depends really upon what economists call the standard of comfort, that is the amount which people feel they must have, and without which they cannot get along. If they cannot get it at one sort of work, or in one place, they will try for other sorts of work, or move to other places. This does not necessarily mean that every one will move, but that if any particular trade cannot, for some reason, pay what the workers feel is a wage sufficient to maintain their standard of comfort, new workers will not enter the trade, and the supply will steadily diminish. Here again we must guard ourselves against thinking of the supply of workers as anything fixed, it, too, is more like a stream, continually fed by the new young people growing up and getting to a self-supporting age, while the older people stop working, retire, or die.

The standard of comfort is constantly rising, and the modern workers expect, and rightly expect, a degree of comfort much beyond that which was enjoyed by their predecessors. Just now, after the war, we are all faced with the difficulty of maintaining anything like the standard of comfort which we had grown to expect, in a world made infinitely poorer

because of the destructive forces which have been at work. Immense numbers of people are living at a standard far lower than seemed likely before 1914, and this is much truer of other countries than of our own. Nothing is so difficult or so unpleasant as to be obliged to lower one's standard of comfort suddenly and considerably, just as few operations are easier than to raise it if one has the means.

If the conditions of wages are such, in any industry, or in any country, that the ordinary standard of comfort cannot be maintained by the workers, we may be sure that the supply of labour for that industry will fall off. Then either the industry must cease to exist, if it cannot pay a wage which the workers feel to be what they need, or else it must so change its methods that it becomes able to pay that wage. It may be changed by an increase in the efficiency of the workers themselves, or by an improvement in the methods of management, or by both.

In real life, these two forces, efficiency, which is the key to wages from the demand side, and standard of comfort, which is the key from the point of view of supply, are constantly acting and reacting on one another. Nothing so stimulates a worker to maintain and increase efficiency as a high and rising standard of comfort. And a worker who has a low standard of comfort is hardly likely to be efficient. Every one can illustrate this from experience. Most of us have known cases of people who had a low standard of life, and were content to get along in a very inefficient manner, just earning enough to keep themselves in the uncomfortable sort of way which was all that they desired. Then something happened: some new

influence was at work, perhaps a capable wife, or the prospect of one, who had herself a high standard of comfort. The inefficient wants to become efficient, and if he wants it enough, he will become efficient. He keeps time, gives his mind to his job, finds out how those of his fellows who are the best workers differ from those who like his former self are the worst.

Or again, many of us have known people who through no fault perhaps of their own, but from some physical weakness, or some want of training, could not earn enough to make themselves efficient. Somehow the difficulty is solved, perhaps a surgical appliance, perhaps a few months in good air, even a change of climate, or some special training. Once more the inefficient has become efficient, and not only the worker himself, but the whole community, is the better off, for the 'social debtor' has become the 'economic man.'

A high and rising standard of comfort is then likely to increase efficiency, and increased efficiency is the only possible way to maintain and increase the standard of comfort. In the imperfect world in which we live, things do not always go smoothly in the short run, and we may find people, owing to some discovery or invention or change in demand, with a great increase in earnings, and without a corresponding increase in the standard of comfort. Unused to the amount they have at their disposal, they spend it in ways which do not increase efficiency, and may diminish it. Or again, some change, possibly in a far-away land, may make the production of a commodity so unprofitable that the industry cannot pay

the wages necessary to maintain the standard of comfort of the workers. The result must be a diminution of efficiency, through no fault of the workers, and the burden will be borne by those who are unable to leave the industry and to find fresh work at a sufficient wage.

Changes of this kind mean the existence of social and political problems with which statesmen must deal, and about which citizens must think. But their thoughts are likely to be more effective if they see the problem in all its bearings, economic and otherwise, and attempt to solve it perhaps by working along rather than against what seem to be the lines of economic development and the increase of productivity.

We can find an obvious illustration in the rapid development of motors, which meant difficulties to the older men such as grooms and coachmen, who had spent their lives among horses, knew everything there was to be known about them, and did not take kindly to the care of machines instead of the management of animals. The younger men could learn, the boys took up motor driving when they entered life, instead of going into the stable. But it was hard on the older people. Yet motors have been, on the whole, a great benefit to mankind, and any plan which had checked their production for the sake of those who were interested only in horses would have meant an injury to mankind as a whole, apart from grooms, coachmen, and the breeders of horses, and probably a check to productivity and the increase of wealth. It is the business of the economist to make clear the workings of economic forces, it is the business of

statesmen, and of the ordinary citizens by whose views statesmen must be guided, to smooth over the difficulties which progress or change may bring.

WOMEN'S WAGES

It is worth while to spend a little time in thinking over the question of women's wages, partly because it is a very good illustration of the theory, but also because it is one which is important in itself, and may become more important. The number of women who are wage-earners has gone on increasing, and during the war, as every one knows, it increased very rapidly. Women's earnings have tended to be less than men's. Is it because they are less efficient, or because the supply is greater than the demand, or why?

In the first place, the ways in which women could earn were, and are still, very much fewer than those open to men. For a long while custom or prejudice confined the work of women to certain well-worn channels. The experience of the war proved that they could, if they were permitted, do a good deal of work that had hitherto been performed by men, and do it, especially when allowance was made for their want of training, with a considerable degree of efficiency. As a result of this experience, the *legal* barriers which had kept women out of certain fields of work were removed, and in law now the chances of men and women are equal. In *fact*, however, this is not so, and women are still kept, by custom or prejudice or trade regulation, out of certain trades or branches of trades.

The result of the smaller number of openings available for women was that those that existed were very much overcrowded. Supply was much in excess of demand, and wages were as a result often very low indeed. This in turn affected efficiency, and sometimes the women who could earn very little were as a result not worth very much. It is what people are fond of calling a vicious circle: earnings were low because efficiency was small, and efficiency was small because earnings were low. This was especially the case in those industries which were by custom considered specially appropriate to women, and into which women consequently crowded in great numbers.

In the war years the number of openings for women was greatly increased. There were scarcely enough women to meet the demand for women's labour instead of their numbers being greatly in excess of demand. Wages rose, and with the increase in wages came an increase in efficiency. Over and over again it was found that women, who had never before earned enough to keep themselves properly fed or to buy good strong boots, became enormously more efficient when they were well fed and well clothed. Once more people who had been almost if not quite 'social debtors' became 'economic men' to the advantage of everybody.

One difficulty in keeping up women's wages, in addition to the restrictions upon the industries at which they can work, is that they have without doubt a lower standard of comfort than men. The ordinary man takes it for granted that he will and must earn enough not only to feed and clothe himself, but to go

at least part of the way towards supporting some woman who will cook and wash and mend and clean for him. The ordinary woman takes it equally for granted that she will do all or nearly all these things, for herself, as well as do the work by which she earns her living. The result is that as, properly speaking, both home-keeping and industrial work are full time jobs, she does not do either of them very well, and her efficiency as a wage-earner is diminished.

She is, shall we say, too tired to cook for herself when she comes home, or if she is not too tired she wants to spend her leisure in a more amusing way, and the result is that she is undernourished and inefficient. A woman who works ought, just as much as a man who works, to earn enough to pay some one else to cook and clean and wash for her, if she is to be as efficient as she is capable of being. But it looks as if it would be some time yet before women, or men either, quite thought this. Man takes it for granted that some woman will look after him, woman takes it for granted that she will look after herself. It is a very clear illustration of the way the standard of comfort and efficiency act and react upon one another.

It is also true that men assume that sooner or later they will need to earn enough not only to provide for the woman who makes them comfortable at home, whether she be wife, mother, or landlady, but also to maintain children until they reach an age at which they can maintain themselves. And although many women have dependents, and many men have none, as things are at present, though no one is rash enough to say how they may change, the standard of comfort which, from the point of view of supply, determines

the man's earnings is one which takes for granted the existence of children whose father will support them.

There is still another reason for the low level of women's wages, and that is that many of the women who work are not wholly dependent upon their earnings. They are partly supported by some man, father or husband. Consequently they are willing to take less than is really enough to support them, and this means that those other women who have to provide for themselves entirely are far below efficiency level, for they cannot, especially in view of the overcrowded state of most of the trades open to women, get more than the partly supported women do, and thus what they earn is wholly insufficient.

The remedy for this, from the economic point of view, is not to forbid those women who are not entirely dependent upon their earnings to work, for from the point of view of production the more people who are producing, the more wealth there will be to distribute. Rather is it that women should come to understand what effect their willingness to take what are sometimes called 'pocket-money wages' have upon the other women who are entirely self-supporting; so that they will not work unless they can obtain a sum sufficient to maintain the standard of comfort. The competition of wage-earners who are not wholly dependent upon their earnings, and who do not understand the effect of their action upon others, almost always tends to keep wages down.

Here again it is not for the economist to advise, but it is for him to point out the bad effects, economically, of the existence of people whose efficiency is

much less than it is capable of being. The opening up of new forms of employment, so that the older are less overcrowded, the raising of the standard of comfort, and the increase, by better training or otherwise, of efficiency, will not only improve the condition of the women workers themselves, but of the whole community as well.

PROFITS

WHAT DETERMINES THE RATE OF PROFITS

We have already come across a number of words which we use in ordinary conversation to mean several different things, and which in economics have a strict and precise meaning. *Profits* is one of the worst of these tiresome words, for while it means all sorts of things in everyday life, it has not always been used in exactly the same way even by economists. The earlier writers included *interest* in profits, and we still need some word to describe what may be over after all the agents of production have been paid. That is, after rent, interest, wages, and the earnings of management have been met, there is sometimes a surplus which is available for division, and which will probably be divided between the wage-earners and the managers according to the strength of their respective bargaining power.

Some people call this surplus profits, but the more ordinary use of the word, and the one we will adopt, is that profits are the payment to the business manager for the use of his business ability, his powers of organisation. We will not include interest, as did the earlier people, who were accustomed to think of business which was managed by people who owned the capital employed, and who were therefore capitalists as well as business managers. Nowadays, although

this still happens, many businesses are run entirely or very largely upon borrowed capital, for which interest is paid, and it is therefore much easier to work out the forces which determine how much the actual business manager will get.

His profits will clearly depend upon the difference between the price at which he can sell his goods, and what it will cost him to produce those goods, when he has paid all his expenses, his rent and interest, his workers, his insurance, and the cost of his raw material, and has put aside what is necessary for repairs, depreciation, and repayment of capital. Now the price at which he can sell will be for the moment fixed by the competition of all the other producers of the same commodity, and the state of the demand for it, and he will make his calculations upon this basis.

The problem for him is how he can reduce his expenses of production. He can do this in several ways.

In the first place, there is the purchase of the raw material. A very great deal may depend upon the buyers employed for this purpose. If it is bought at the right moment, and in large quantities, much may be saved. The incompetent manager buys from hand to mouth, tries to save perhaps by buying cheap lots, which may turn out very bad bargains, and probably refuses to employ expert buyers, who would really save him large sums by their special skill and knowledge. The skilled manager avoids all these mistakes.

Then there will be the question of selling. The skilled manager will have that special knowledge of markets, of when and how to sell, which seems almost to amount to an extra sense. And again he will know

how much it is worth while to spend upon the employment of good selling agents, or buyers. There is an old but true pre-war story which illustrates this. Once two sellers of ready-made ties, one English and the other belonging to another race, met, let us say, in Sweden. Now it happens that the Swedish custom is to fasten these ties upon one side, while in England they fasten upon the other. The English ties were far superior in design and material, but the Swedish hosiers would not give orders for them unless this little trouble in fastening could be got over. The other man at once quoted prices for ties made to fasten in the Swedish manner. The Englishman said, 'If they won't fasten their ties in the right way let them do without.' It is obvious who got the orders. So that here the manufacturer had produced admirable ties, but he failed to sell them because of the incompetence of his traveller. The moral is that much may depend upon the skill of the agents employed to market the produce.

But perhaps most of all the skilful business manager can show his ability in the matter of his workers. The stupid man will once more practise false economies in lighting and heating his workshops, in his organisation of work, in his arrangement of machines. For want of enough light work will be spoilt, for want of good ventilation, enough breaks in working hours, convenient arrangements for meals, the workers will be far less efficient than they might be if all the conditions were good. Bad air, cold, poor light, long hours, all make people fumble-fingered and likely to make mistakes and spoil material.

The skilled employer, on the other hand, will know

that capital spent upon providing really good conditions for workers will repay itself over and over again. He will watch and observe, he will know how long at a stretch his workers can work without beginning to get tired, and he will see that they stop short of that point. Then, too, he will understand that low wages spell inefficiency, and that cheap labour is often far too dear. In modern conditions the actual amount paid may indeed be fixed by the Trade Union and be the same for all employers, but nevertheless there is great scope for skill in management in this matter.

Nothing is so characteristic of what we might call the marginal employer, that is some one like the stupid man we have described, as an attempt to keep down wages to the lowest possible level. The result of low wages and bad conditions is that only the least efficient of the workers are likely to be willing to take the work: the better will have gone to factories run on more satisfactory lines. So that the marginal employer is often, indeed usually, managing the work of marginal workers, and the result is not likely to be highly productive.

There are many other ways in which the employer's skill can be shown, in his development of new markets, in his knowledge of the course of trade, in his watch for new and improved methods and new or improved machines, and in much else which it is not necessary to discuss at length. The marginal employer generally holds the view that what was good enough for his father is good enough for him, and that why people want all these new-fangled ideas he is sure he cannot imagine. It is not only the marginal employer, by the way, who feels like this, but a good many other

people who are also rather marginal from the point of view of the community. The skilled man will feel that if it was good enough for his father it cannot possibly be good enough for him, and he will keep an open mind, and a desire to profit by all the discoveries of science, and to employ the best educated people he can find for those parts of his work which need reflection, observation, and the power of thought.

We need not develop this, but we ought now to be able to see how mistaken it is to suppose that high profits need mean either low wages or high prices. If we follow a little further the careers of our two imaginary friends, the marginal employer and the highly-skilled man, we shall see that, while selling prices are the same for both, one will produce a few articles, at a high cost of production, the other many at a low cost. In course of time the highly-skilled man, with his cheap raw material, his well-equipped workshops, his highly efficient workers, may find that it would really pay him to lower the price at which he sells his commodity. It will make him unpopular with his less competent fellow producers, no doubt, but perhaps his new-fangled ways have already had that effect, and he does not mind. The effect of his action will be, however, that the marginal employer, who only made just enough profit to keep going, can no longer survive. He is obliged to give up, find another way of earning his living, and as it is clear that from the point of view of the community as a whole he is not really suitable for the business of employing, we need not regret his departure. High profits, when they result from a high degree of skill, may, and often do, mean low prices and high wages.

In real life there are a number of other things to allow for, of which luck, sheer luck, is not the least. But from the point of view of production, the making of high profits may be a good and not a bad thing, if it is the result of real skill. It is always worth while to pay high for the use of exceptional ability. If we will not pay for it we may lose its use, to our loss if to some one else's gain. Abnormally high prices over a whole industry may suggest something wrong in distribution: high profits made by certain individuals suggest remarkable ability, from which every one may benefit.

In real life, the business manager may be employed by the owners of the capital, and paid a salary. In that case true profits would be (*a*) his salary; and (*b*) anything over and above that, which was due to his ability, after all the other charges on the business had been met. In cases of salaried managers, the amounts of their salaries will depend upon the demand for and the supply of managers of the standard of ability required. It does not seem probable that the salary will often fall much below something very like what the man in question could have earned for himself if he had borrowed capital and gone into business on his own account, because if much less were offered him, into business on his own account he would go. So that once more here we are first at demand and supply, and ultimately at ability or efficiency or productivity, whichever word we like best.

On the other hand, the cautious may prefer to work at a salary rather than go into business for himself, even if the salary offered is a shade less than what he believes he could earn. For being a business

manager, however great its attractions, is an adventurous affair. Every one else has to be paid before the manager gets his share, and if there happens by ill chance to be nothing left over, none of the others are likely to give up their shares or any part of them to him. His rent must be paid, so must his interest, and the wages of his workers; his is what people call the residual share.

And it is always possible that causes entirely beyond his control may reduce that share to nothing. An earthquake in China means a great falling off of the Chinese demand for cotton. War in the Near East may stimulate the production and sale of guns or ammunition, but entirely do away with that for something else. Fortunes made in a war have many a time vanished altogether in the slump after the war is over. So that those who make profits must always face the risk of there being no profits to be made, and consequently they may make more than seems enough to maintain them in full efficiency one year, or for several years, knowing that in the next period they may have all they can do to hold on and pay their way and will get no profits at all.

EXPERIMENTS IN DISTRIBUTION

PROFIT-SHARING AND CO-OPERATION

A NUMBER of attempts have been made to settle the questions which arise between employer and employed. Up to a certain point the interests of these two are, or ought to be, the same. The employer wants his workers to be as efficient as possible, and ought therefore to be ready to pay good wages; the workers want as good organisation as possible, and ought to be glad to see high profits. Nevertheless there is, as we all know well, a lack of agreement from time to time as to how high these wages and profits should be, and whether one side or the other is getting more than its fair share of what is produced.

The principle of *profit-sharing* has been tried by a number of businesses, here and in other countries. The plan is that there should be a standard rate of wages, a standard rate of interest upon capital (to include allowances for depreciation and risk), and a fixed amount for management. Any surplus that may exist after these payments are made is divided between management and workers, or management, workers, and shareholders, according to an agreed rate, and there is usually a plan by which part of what the workers get is paid in the form of shares in the capital of the business. That is, the workers become

shareholders, get interest upon their shares, and are capitalists as well as workers.

The advantages of this plan are that friction is avoided, once the arrangement is made that both the workers and the management are equally interested in getting the best possible result, the greatest possible output. The better this is, the more there will be to divide between them. The difficulty is that, as is usually the way in this world, the industrious and efficient only get the same share of the whole as do the lazy, though they have done more to produce that whole. But it is also true that the industrious and efficient, knowing this to be the case, will probably take pretty good care that the lazy are not lazy, and do their fair share of the work.

Another difficulty is that if there should happen to be a loss instead of a profit, it is difficult to see who will bear it. Under ordinary conditions the extra profits of good years weigh against the losses of bad times. However, the system has worked remarkably well in some instances for a very long time, and has led to prosperity and contentment. It is not, however, approved by some of those who have influence with the workers, and perhaps for this among other reasons has not spread as much as was once hoped.

Co-operation is another plan. Here the idea is to use the brains, organising capacity and capital of the workers themselves, and thus to do away with the employer and the capitalist. In the case of productive co-operation (that is actually making goods) each worker contributes a certain amount of the capital, on which he is paid interest. The management is done partly by a paid manager, and partly by a

committee of the workers. After the standard rate of wages, the salary of the manager, and interest on the capital has been paid, the surplus is divided among the workers, who thus get what profits, or surplus, there may be, whether it is due to the organising skill of the committee, or to general trade conditions.

In distributive co-operation (the stores familiar to most of us, which sell, that is distribute, groceries, boots, and other needs of daily life), the capital is provided, not by the workers, but by those who buy the goods. Each member must pay in a certain amount on joining the society, and anything he may get in dividend on his purchases is kept back until he holds a certain amount of capital. Here the extra profits, or surplus, after wages, interest, and salary of managers is paid, is divided among the purchasers in proportion to their purchases, and the managing committee is elected from and by them. The co-operative stores are themselves members of the great co-operative-productive bodies (the Co-operative Wholesale Societies), and thus the two sides of the co-operative movement are closely linked up.

There are other co-operative organisations which deal especially with agriculture, and in some countries there are all sorts of co-operative bodies, from dairies to banks.

The co-operative movement is without doubt one of the most living and real in industrial life. Out of the surplus, sums are put aside for educational and social purposes, and the whole movement is growing in many directions. There is an immense body of co-operators, and a deep devotion to the co-operative

ideals. From the economists' point of view it may be said to use what otherwise might be lost, the organising skill of the mass of the people, through their committees. Probably also it uses capital which would otherwise be hoarded or spent unproductively. There are still certain difficulties to overcome. One is the unwillingness of many committees to pay salaries which attract really good brains to managing, and this weakness is only partly made up for by the help of the committees.

Again, it is not easy to see how far the co-operative plan would succeed in the complicated business of producing for foreign markets, with their perpetually changing demands, which need great skill and elasticity in management. In producing for a steady demand and the home market real success has been attained. The difficulties between employers and employed are not entirely solved. Disputes about wages and conditions of employment arise and have to be settled between the workers and the co-operative committees who employ them, and strikes occur from time to time much as they do in ordinary trades. But despite all difficulties the co-operative idea is becoming more and more widely understood, and in so far as it succeeds must be using productively what might otherwise be wasted, the brains and capital of the ordinary man and woman.

TRADE UNIONS

Trade Unions are not, properly speaking, an attempt to solve the question of distribution. They came into existence rather to strengthen the bargaining

power of the worker as against the employer, so that both shall meet upon an equal basis. Organised labour can obtain conditions which might be impossible to a number of separate individuals, each making his own terms. From the economic point of view it is clear that the fixing of a standard rate of wages ought to mean the fixing also of a standard rate of efficiency, for unless there were a very great shortage of workers, and then only for a time, clearly no employer could pay a man the standard rate unless he were worth that rate. Consequently the worker must make himself worth that rate, or he cannot get employment.

The obvious but probably inevitable result of the fixed rate is that those who can only work part-time, the old perhaps, or the weak, cannot be employed. This difficulty is specially pressing just now, because of the existence of many men rendered unable by their sufferings in the war to earn the full rate, but able to earn something. It is waste to keep them idle, when they can produce, and wish to produce, but they cannot earn the full standard rate. The difficulty is one which can be got over, but it must arise when a fixed and inelastic rate is thought necessary in order to maintain wages at a certain level.

With the political developments of Trade Unionism the economist is only indirectly concerned, but the growth of Trade Unionism, and the power of the great Unions, is one of the most interesting and important chapters in the economic history of the nineteenth and twentieth centuries. Apart from determining the rates of wages, Trade Unions carry out an immense amount of work for their members. They pay him sickness allowances when he is ill,

and unemployment allowances when he is out of work, travelling allowances when he is moving from one place to another in search of work, and help him in all sorts of ways. Various other plans are being and have been tried. The idea of all of them is first to ensure a sufficient wage and profit to make production as efficient as possible, and next to divide any surplus that may arise not only by the 'pull of the market' but rather by peaceful and friendly discussions between employers and employed.

SOCIALISM

Finally, we must deal with the idea of what is called *Socialism,* a vague word which is used to mean a number of different plans. The main idea is always the same, though the working out changes. Socialists want a complete change in the underlying motive, the mainspring of economic society. Hitherto this has been the desire of most people to have as much as they can get, and this desire is only checked by their wish not to do a very great deal of work. Most people want to do some work, but not very much, and if it were not for their wish to have rather more comforts than they possess, or to be sure that their children have them, the wealth of the world would scarcely increase.

Putting it shortly, men work for reasons of private or self interest, for the sake of themselves or those dear to them. It is believed by many that other motives would produce better results. Self-interest, they say, has led to great production, but not to very satisfactory distribution, and even production has not

been as great as it might be because it has been checked by the feeling that some one is getting more than his fair share of the product. All sorts of different schemes have been suggested by which the state should own land and capital and manage employment. Since the war, when the state did a great deal of managing, and most people disliked its management extremely, other plans have been more popular. The idea at the bottom of them all is the same, that people will work better, and that a fairer distribution of wealth can be obtained, if the work is not done for individual employers but for the community as a whole.

As a matter of fact, there are now very many people who work for the community, every one in the post office, for example, or any one who is employed by a town or county council, and it cannot honestly be said that they are more productive and efficient than those who work for private firms. This may be due to imperfect education, but it is possible that with better education the present system could be considerably improved.

The economist must, as far as he is able, look upon all these schemes with an impartial eye, and try to discover what their economic results would be. He sees that self-interest has certainly led to immense improvements in production, that distribution is still very imperfect, but that it is improving, and that there is a tendency towards greater equality. Some of the rich may be getting richer, but without doubt so too are the mass of those who were the poor.

The war has interrupted everything, and made all tendencies difficult to observe, besides terribly diminishing the amount of wealth that can be distributed

at all. The economist sees, on the one hand, the undoubted difficulty of getting good results from an unpopular system of production, and on the other the equally certain difficulty of organising upon other lines production for foreign markets, and of living in a world which is managed upon the basis of competition and self interest. A small simple community, which mostly produces what it needs for itself, can do many things which are impossible, or at least very difficult, for an enormous modern nation living in the modern world of buying and selling, of exchange all over the world, of dependence upon foreign markets not only for what is sold but for what is bought.

His business, however, is to examine the various schemes, to point out, as far as he is able, their advantages and disadvantages, and to leave others to use these results and to weigh them against those which are not purely economic, but social and political. And the student of economics or of politics will find much to interest him in the ways by which man has tried to prevent the crude forces of competition and self-interest from harming the weak, while at the same time the desire to gain wealth is not checked. There is a general agreement that some interference is necessary : in this country we have, for example, Factory Acts, Trades Boards, and other legislation. How far the state can and should, in the interests of the community as a whole, restrict the activities of employers and employed, or any other section of society, is one of the largest and most difficult, as well as most interesting of the questions which students, citizens, and statesmen must all consider.

SUMMARY

Dividing, then, those who share the total product, the whole amount of wealth produced in any given period, into four classes, we have discovered the main principles which determine how much each of them can get, in the world organised, as it is now, mainly on competitive principles; supposing that they are all equally able to move about, equally able to have a full knowledge of the conditions of the market, and are of equal bargaining power. In real life none of these conditions may be altogether true, though it is probable that most of them very largely prevail over a great part of the economic world.

It is no affair of the economic student, as such, to consider whether any or all of these payments, rent, interest, wages, and profits, are right or wrong. It is his business to know how and why they are as they are, and to be able to reason for himself about the economic effect of changes. From the point of view of the production of wealth he can say something like this.

It is best (that is, most likely to increase production) not only for individuals but for the community as a whole, that the owner of land should get just so much rent as is sufficient to induce him to manage his land in the best possible way, and to see that it is made to produce as much as possible. It is again best that interest should be at a rate which induces

the greatest amount of saving, while at the same time ensuring to industry a steady flow of capital at a moderate price. The workers, if they are to be as efficient as possible, should receive wages which enable them to maintain that efficiency, and support their families according to the standard of comfort which is required by that degree of efficiency. And lastly the reward of the manager or organiser, the man who puts all this vast machine into operation, should be sufficient to induce him to put his whole energy into business, and should, too, be sufficient to attract people of the very best brains and ability.

None of these conditions is exactly fulfilled in most communities, partly because so few people, comparatively, recognise their importance. Energy and ability are wasted in disputes which might go into production, and the discouragement of ability means the continued existence of marginal employers paying marginal wages to their workers. And again, the existence of large masses of cheap and probably therefore not efficient labour tempts into existence, and keeps in existence, the marginal employer who has not enough brains, or enough energy, to provide the conditions under which high wages are worth paying. Moreover, every now and then, in some places or some industries, for varying reasons, productivity becomes so low that those wages are not earned, and then employment falls off and distress follows. Distrust, discontent, insecurity, a feeling that some one else, whether he be wage-earner or landlord or employer or capitalist, is getting more than his fair share, all these are conditions which make for the opposite of productivity.

And until some efficient plan for dealing with unemployment has been worked out, unemployment, and the fear of unemployment, is one of the greatest possible hindrances to production. If every one did get just as much as was enough to keep him as productive as he could possibly be, and there was no more than that to be divided, the problem would be comparatively simple, though we have not in actual fact arrived even at that point yet.

But what happens is that there is often a surplus, after the agents of production have each been paid, a surplus which may be due to the combined skill of all of them, or of that of any two or three. Or it may be due to sheer luck or the way things happen. For example, no one can suppose that the amount the owner of a piece of land in the middle of New York, or in the City of London, can get for his land, is only the amount necessary in order to induce him to make the best use of that land. There is obviously a surplus due to the accident of New York, or London, being where it is and what it is. And over this sort of surplus it is very easy to quarrel, and to spend so much feeling in the quarrel that valuable energy is distracted from production. Quite possibly it ought to be so distracted, social inequalities and accidents demand thought and time, but nevertheless the economist is bound to point out that while people are discussing how to remove inequalities they may easily be diminishing the amount that will next have to be divided.

Again, from the point of view of production, so long as the employer and the workers both get enough to enable them to produce as much as they are able

to do, no more is necessary. But actually there is, from time to time, a surplus over and above this, and there is no economic principle to determine how it should be divided.

Perhaps all that the economist can say, before he makes his bow and leaves these matters to statesmen, is something like this. From the point of view of production, which means from the point of view of assuring first the necessaries and then the comforts of civilisation to as large a number of people as possible, the great essential is that there should always be an excess of production over consumption. Probably something like one-fifth of what is produced each year or in any given period, perhaps even more, is needed for replacement of capital, for improvements, and for maintenance. Only when there is plenty of available capital is it possible for improvements and developments, and the betterment of mankind, to have their full chance. So that after all the requirements of efficiency have been met, if there is a surplus, it is to be hoped that it will fall into those hands which will direct it to further production, either directly, by saving and investing, or indirectly, by the endowment of research and education. Whose those hands will be no one can say, and further than this it is difficult for us to go. But a clear understanding of the economic principles which underlie the distribution of wealth is a very great help to improving that distribution, in a manner which will not mean the diminution of the total available amount.

EXCHANGE

VALUE AND PRICE

CAUSES OF VALUE

In early society there is no question of exchange. Each person, or group of persons, produces what is required for themselves, or rather, as much of what they want as they are able to obtain. But as soon as there is a division of workers, some doing one thing and some another, there must be exchange, and thus arises the problem of what determines the *value* of any particular thing. That is, suppose one man or one tribe has more than he or they need of one kind of produce than another, while the second in turn has a surplus of something else, what determines the quantities in which the two shall be exchanged?

It is clear that in every exchange there are two sets of feelings to be considered; first, there is the person who has something he wishes to dispose of, and secondly, the other person, who wants the something.

At this point it will be well to define *price*. Price is value expressed in terms of some one thing which is called *money*. It does not matter what the one thing is, as we shall see when we get to Money, but it is obviously convenient to have some one thing to measure all the others against. Imagine the endless bother of measuring cows against honey or boots or horses. Man has got over that difficulty by the invention of money.

If the farmer wants to sell a cow, and the bootmaker wants one, the farmer need not go off with boots enough to last him for years: he can take money, and with the money buy boots and anything else he wishes. But for the moment we need not think much about money, so long as we remember that price is the ordinary and convenient way of describing value.

Now we saw at the beginning that in order to be valuable, a commodity must have certain qualities. It must be wanted by some one, and the some one must be unable to get it for nothing. Sunshine has no economic value, we cannot buy it and sell it. But mutton has, people want it as they want sunshine, but it is not a free gift of nature, at all events in this part of the world. If we would have mutton for dinner we must be prepared to give something in exchange. In other words, it has value.

Anything which has value, then, will be wanted or *demanded*, as the economists say, and it cannot be had for nothing. The supply is not unlimited. The value of a thing may and does change with changing tastes, and things which have value at one time may have none at another. If we were all colour-blind a large number of things would undergo a very considerable fall in value. What, for instance, would be the selling price of the pictures in the National Gallery? Changes in fashion bring changes in value, so do new discoveries and new habits of life.

SUPPLY

We can divide things into several groups, according to the circumstances which decide their value.

There are some things of which the supply is absolutely limited, obvious examples are the first edition of a book, or a picture by an artist who is no longer living, or furniture made at a certain time. The value of things of this kind will depend entirely upon how many people want them, and how much they want them; as economists say, by the intensity of the demand. Pictures by certain artists sell for fabulous sums because people want them so much, and if a thing is scarce enough and if people want it very badly, its value may rise extremely high.

There seems indeed only one obvious limitation, apart from the fact that no one, or no group, has unlimited wealth, and that is that when things are very dear it becomes worth while to imitate them, and to do it so well that although the very best experts will not be deceived, other people will, and their demand will be satisfied by the possession of the imitation, and will not remain to compete with that of the expert. The making of sham old furniture is a well-recognised trade, which demands a good deal of skill, and no doubt results in making many people happy in the possession of what they believe to be genuine old furniture, while those who have the real thing have perhaps had to pay less for it than they would have done had it not been for the skill of the forgers.

The second group contains things of which the supply is unlimited but of which the price, owing to the working of the law of diminishing returns, increases with every increase in demand. The obvious example here is most kinds of agricultural produce. The price of potatoes (let us say) is fixed by the expenses

of production of the last sack of potatoes which will be grown in response to the demand for potatoes at that moment, that is the expenses of production on the least favourable piece of land upon which the conditions of demand for potatoes make it worth while to grow them. How keen the demand for potatoes is will depend upon the price, and also upon the habits and tastes of people, and upon whether there is anything else which can be used if potatoes become dear. But at any moment the price cannot fall below the expenses of production upon the least favourable land, for if it does fewer potatoes will be grown and some one will have to go without. Nor can it go above that amount, for if it did more potatoes would be grown and some grower would find himself unable to dispose of his supply.

The third class of commodities is that of which there is any amount, again, to be had, but of which the more that is wanted the cheaper they get, because they can be produced more cheaply in large quantities than in small. Most manufactured goods have this pleasant quality, and are therefore said to be produced subject to the law of increasing returns. It is easy to understand. Let us take printing for an example. Many of us know that if we want to get a notice printed, of a concert perhaps, or of something we have lost, the first question is how many copies we shall want. If we need only a few they will cost a good deal each, and the price for each notice will be less the more we have. For the main expense comes in setting up the type; after that is done the mere rolling off of copies is not much trouble, and the more the initial expense of setting up the type

can be spread out, the cheaper will be each copy.

Clearly the more work that can be got out of each machine the better, and the more thinly, so to speak, can be spread the cost of the machine. So that in things of this kind the price will again be determined by expenses of production, and what those expenses of production are will depend on the demand. If the demand is great, the expenses will be low; if the demand is slight, the expenses will be high.

Lastly, there are said to be commodities of which any quantity can be produced, and of which the expenses of production will remain the same whether few or many are needed. It is not easy to think of examples of things produced thus under the law of constant returns, but we can imagine some of which the raw material is produced under the law of diminishing returns, while they are manufactured under the law of increasing returns, so that the one just cancels the other. It also seems possible that hand-made goods would to some extent come under this law. After a certain degree of skill has been reached, and provided that the worker does not go on after fatigue has diminished the pace of working, each pair of hand-knitted socks, or each thousand words typed, shall we say, cost the maker just about the same.

MONOPOLY

There are certain exceptional cases which cannot be made to fit properly under any of these rules, and the most important of these are things which are produced subject to conditions of *monopoly*. That

is, the supply is not produced under conditions of competition, but is controlled by one person or one group of persons. There may be natural monopolies, or artificial monopolies. The water supply of a town which has no wells, but is obliged to have its water brought from outside, is a natural monopoly, because there is only room for one set of water pipes in the ordinary street. Or we might think of something which grows only in one particular place. A mineral spring with special qualities unlike those of any other spring is an example.

Artificial monopolies are much more familiar. They may be the result of laws, or of the combination of all the people who produce the article in question, and we became familiar with them during the war, when governments were obliged to 'control' and to buy up the whole supply of something, for instance sugar, in order to make sure that people should have it, and that it should be fairly distributed. In the case of controlled articles governments regulated the price as well as the quantity, and as they were not guided by ordinary business motives and did not want to make a profit, these examples do not fit under ordinary economic laws. But in the case of monopolies, whether natural or artificial, the price will depend upon the demand, and all we need say about the expenses of production is that the price will certainly not go below. How far above it can go will depend entirely upon the demand. It may go a very long way, and then those who own the monopoly will make a fortune.

In the case of an artificial monopoly price is less likely to go a very long way above the expenses of

production, because if it is suspected that extra large profits are being made by any set of people, others will try to break down the monopoly and share in the profits. So that even if there is no actual competition the possibility that it might come into play helps to keep down price. For instance we often see several different milkcarts going down a street in the morning, and one result is that each of us pays about the same for our milk, and gets it of about the same quality. For if one milk-dealer tried to raise his price above that of the others, or watered his milk, he knows that his customers would leave him and buy from one of his rivals.

But suppose the milk-dealers formed a ring or combine and forced up the price of milk? What would happen? The more enterprising of the customers might try, with the help of a goat in the back garden, or of dried or tinned milk, to diminish the milk ring's profits by diminishing the demand for milk, until the ring found it paid them better to lower the price again. In any case a rise in the price in milk would probably mean a falling off in demand, even without the help of the goat. But this is not all. Suppose one of the people in the street has friends or relations in the country. He may arrange with them for an alternative supply of milk. Once more there is competition, and prices will again come down to expenses of production.

From the point of view of the producer then, price must depend upon expenses of production. It cannot go below, or he will stop producing, and the competition of other producers is not likely to let it go above for long, or to any great extent. The price, that is, must

be enough to meet all the expenses of producing the commodity and bringing it to the market, and that means enough also to induce the producer to go on producing, and the various people concerned in the selling to go on with what they do. Every one, that is, from the first producers down to the shopkeepers, must find it worth while to do their share of the work. But what those expenses are depends upon demand, whether the commodity is produced subject to the law of diminishing or of increasing returns.

DEMAND

Let us for a moment think about the feelings which will influence buyers, and determine their demand.

The first thing is certainly *Price*. When prices rise demand is likely to fall, and when prices fall demand increases. This fact is familiar to us from our daily experience. We may also remember that there are only a very few really rich people, more who are rather rich, more still who are not rich but comfortable, and most who are neither rich nor poor but ordinary. There are also the really poor. Now as there are very few rich, anything which costs a great deal can in the nature of things only be 'demanded' by a few, and as price falls, more and more people are able to buy the commodity, whatever it may be. Tomatoes, which were once the luxury of the rich, have become cheap, and almost any one can buy them.

When demand moves in quick reply to any change in price we say that it is 'elastic.' When, on the other hand, a fall in price does not result in an increase of demand, nor a rise in price lead to a decrease, then

we say that demand is 'inelastic.' The demand for the things that are absolutely necessary is usually inelastic: even when bread is dear almost the same amount is bought as when it is cheap. Not quite, for some waste and, alas, some needs are checked, but the fall in demand is not in the least in proportion to the rise in price. The demand for the luxuries of the very rich is also inelastic, the very rich will go on buying the thing however dear. Indeed there are sometimes people who are foolish enough to buy things *because* they are dear, but they are few as well as foolish, and we need not concern ourselves with their doings.

There are some commodities of which people are not likely to want more than one. Even if the price of dining-room tables were halved, few of us would buy another. The expenses of setting up house-keeping would be diminished, but the number of tables bought would not much increase. Economists say that this sort of demand is soon 'satiated.' The truth is that dining-room tables are not really things of themselves, but parts of a whole; that is, of the furnishing of a house. The mainspring of a watch is another example, however cheap it became the demand would not increase rapidly. We should not have an extra mainspring each, and the cost of one is only a small part of the cost of the watch.

Other things are affected by the possibility of using something else in their stead. If tapioca became dear and all the other things of which we make puddings remained the same, it is probable that the number of tapioca puddings would be very small indeed. In this case the demand is more than elastic, it moves

in almost violent response to a change in price. This is called the law of substitution, and is more important than it appears. For instance, one of the things that would have to be considered if it were desired to raise revenue by taxing anything would be how far that thing was affected by the law of substitution. A tax on tapioca might bring in nothing at all if rice and sago and the rest remained untaxed.

Finally, there are some things for which the demand hardly depends on the price at all. Coffins, cradles, and wedding-cake are examples. In the case of the last two, price would have some effect. If the number of cradles wanted ultimately depends upon the number of babies—and it is safe to say that the price of cradles has no effect upon that number—yet if cradles are very dear some of the babies will go without. Similarly if wedding-cake is dear, although the number of weddings will not be affected, some brides will have much smaller wedding-cakes and others will have none at all.

From the point of view of the buyer, then, demand will generally depend upon price, though in some cases demand is more affected by price than in others. And the value to the buyer of anything will be what he is willing to give for the last portion of it that he can get at that price and is not willing to go without. If price fell he might take more, but at a given price he will only take that amount.

From the buyer's point of view then, demand depends upon what is called marginal utility, that is, the last portion for which it is worth while to pay the price; from the seller's, upon expenses of production, and these two continually act and react upon one another

so that it is impossible to consider either without at the same time thinking of the other.

MARKET AND NORMAL PRICE

Meanwhile, though prices in the long run must always be determined by expenses of production, which in their turn are determined by demand, in the short run they may be above or below the expenses of production. Sudden and violent changes in demand may occur. For example, when the late king died, many people wanted to go into mourning; there was a sudden check to the demand for coloured materials, and a run on black. For a time people were willing to pay rather more than the ordinary price for black, while the sellers of coloured materials found their stock unsaleable. But very shortly matters righted themselves: more capital and work went into the production of black materials, or perhaps into dyeing them, and soon demand was satisfied.

Economists make a distinction between *market* price and *normal* price. Market price is the price for the moment, it may be above or below normal price, but it is always trying to get back there. If market price is above normal price, that is, above the price that is enough to cover all the expenses of production, unusually high profits will be made, capital and work will hasten into the business, and in a short time competition will once more have restored market price to a level with normal price. Meanwhile market price itself may have moved. If the commodity in question was produced under the law of increasing returns, for instance, an increase in the demand, which

at first sent up price, would in the end bring it down, because of the advantages of producing on a large scale.

If, owing to a check in demand, market price had fallen below normal price, people who had stocks in hand, and found they could not sell them at the old price, would be willing to sell at a lower price, doing without their normal profit rather than fail to sell at all. But as soon as existing stocks had been cleared, because the sellers would in future order less of this thing, owing to the change in demand, makers would make less, capital and work would go out of that business and find something else to do, and once more market price and normal price would correspond.

The market price of things like fish and fruit, which perish very rapidly, often changes fast. For example, fish at a shop in a fashionable street, where rich people shop, may be very high in price for the first part of the day, become moderate towards afternoon, and fall so low by closing time as to be within the reach of every one. Probably if the whole day's takings are considered, the fish shop will have made about a normal profit. Market price has swung all round the normal price level during the day, but over the day has just balanced.

Market price, then, is the temporary and changeable price, which depends upon the demand at the moment. Normal price is that which covers the expenses of production. Market price may swing anywhere round normal price, but is always trying to come back to it. And meanwhile normal price itself will not necessarily remain in the same place, but will be moving upwards or downwards, according to whether the thing in question is produced subject to the law of diminishing or the law of increasing returns.

INTERNATIONAL TRADE

WHAT IT IS AND WHY IT HAPPENS

Will the conclusions at which we have arrived about value apply to exchanges which take place between people who do not live in the same country?

In all the arguments we used we took it for granted that capital and workers were easily and quickly moved, so that if less than the ordinary price could be obtained for one commodity, and more for another, people would move from the production of the first and turn to the production of the second. We also assumed that both sellers and buyers had a pretty complete knowledge of what was going on, so that prices could not for long remain higher in one place, nor the average rate of profits higher in one industry, than in any other. These conditions are more or less true when we consider the buyings and sellings of people who live in one country. But they are less true when we consider those of people who live in different countries.

Capital is much more movable to-day than it was fifty years ago, because of the great developments of the banking systems of the world. And workers too move more easily, but no one could argue that they move as freely between different countries as they do within a country. Nor is knowledge so complete, and where knowledge is incomplete competition works

more slowly and less thoroughly. There are all sorts of hindrances to movement and knowledge, differences of language, of currency, of trade laws, of banking systems, custom barriers, railway systems. No one of them may matter very much in itself, but taken all together they matter a good deal.

It therefore seems certain that we must think out changes in the theory of value. Reasoning based on one set of conditions cannot be expected to apply in another.

The value of things produced and exchanged within a country will, we have seen, correspond in the long run with the expenses of production of those things. If we cannot assume this of things exchanged between people living in different countries we shall probably be wise to attack the question from the other point of view, that of the buyer. Clearly no one will go on producing things, whether for home or for foreign trade, at a loss. That is, the value of any commodity cannot, except perhaps for a very short time, fall below the expenses of production. But as competition is incomplete, and capital and workers do not move freely, possibly the value of an imported commodity may be very considerably above its expenses of production.

Let us think for a moment why people living in one country buy things produced in another country.

The first reason is that they import things which cannot be produced in their own land. History students will remember the way the early traders imported spices and other eastern products, which could not be grown in Britain. Nowadays we import quantities of things which we cannot grow at home,

from the everyday tea, coffee, and sugar, to Persian carpets or South African diamonds.

Secondly, things are imported which could be grown in the country to which they come, but only at great difficulty and expense. As Adam Smith pointed out, very good grapes can be grown in Scotland, and very good wine made of them, but no one dreams of growing grapes for wine in Scotland. Instead, we import wine from those countries where grapes ripen freely outdoors. A large number of imports would be of this kind, that is, things which could be produced at home, but can be produced very much more easily somewhere else.

Lastly, it may pay a country to import something which it can not only produce itself, but produce more cheaply or better than can the country from which it imports. This sounds absurd, but is really quite easy. It will happen only when the importing country has a still greater advantage in the production of something else, or of several other things. For instance, the Channel Islands, with their admirable climate and soil, can very likely grow corn more cheaply than we can. But they may instead import corn from us, because it pays them infinitely better to grow early vegetables and tomatoes.

Of course, this plan is not peculiar to foreign trade, it is probably within the experience of any of us. There are some fortunate people who can do many things better than the rest. They are perhaps gifted cooks, or brilliant cricketers, and they are at the same time particularly clever at dressmaking or engineering. They will have to choose which of their gifts to cultivate most, in order to earn their

livings, and they will probably choose that at which they have the greatest relative advantage. It may pay the girl to become a dressmaker, and employ some one else to cook for her, although she feels sure she could do it a good deal better than the some one else. The boy meanwhile has become an engineer and perhaps combines with others to pay a cricket pro. to bowl to him and his friends in their leisure hours.

These, then, are the reasons which make people who live in one country buy goods which are produced in others. Now what determines how much they will have to give for them? All trade is, as we know, an exchange of goods and services for other goods and services. The baker provides us all with bread. In return he gets not only the flour and yeast with which to make the bread, and the coal with which to bake it, but also the groceries, meat, clothes, housing, and other things he wants for himself and his family. The tool we use to carry out our exchanges is money, but money is only a tool, though an extremely useful one, and what really matters to us is not only how much money we can get for what we do or produce, but also how much we can get for money.

HOW IT WORKS

Trade between people living in different countries is just as much exchange as trade between neighbours, only its workings are a little more difficult to trace. Let us, for convenience' sake, imagine only two sets of people, shall we say English and Spanish, and two sorts of things exchanged. The English want oranges

the Spanish want tram-rails. How many oranges will the Spanish have to give in order to get the tram-rails they need? This depends on how much they want the tram-rails. Suppose one cargo of oranges when sold in England would fetch as much as it cost to produce the tram-rails, and something over as well. The making of tram-rails for the Spanish market is a profitable affair: we will make more rails.

But the Spanish do not want the next set of rails quite so badly; moreover, when we come to sell two cargoes of oranges in England neither are the English willing to give quite so much for more oranges than they were for the first consignment. The demand for oranges may be fairly elastic, but when there are twice as many as there were we shall have to lower the price if we are to get rid of them all. But nevertheless it is still profitable to make tram-rails and import oranges and the business will go on. The amount of oranges that will be given for a certain number of tram-rails will depend on whose wants are the strongest. If the Spanish are very anxious for tram-rails they will be willing to send quite a quantity of oranges in exchange for them. England will get her oranges and will only have to give a comparatively small amount of tram-rails in exchange.

Or perhaps it is England who wants the oranges, and wants them so much that she is willing to send a considerable number of tram-rails rather than go short of oranges. In that case Spain will get her tram-rails cheap. There is a downward limit each way to the amount each country can give. However much England may want oranges, she will not give more than a certain number of tram-rails for them. The oranges,

when sold, must pay for the expenses of production of the tram-rails or else clearly the transaction cannot go on. Similarly, the tram-rails when sold in Spain must fetch enough to cover all the expenses of production of the oranges.

But if Spain has a special advantage in the growing of oranges, and England one in the making of tram-rails, the exchange may prove very profitable indeed to both parties. The exact amount of oranges and tram-rails which will be given for each other will be settled by the strength of the two demands, and will in the end be fixed at that point where both are satisfied. The value of oranges can be measured in tram-rails, that of tram-rails in oranges. That is what is meant when the economists tell us that the value of an imported commodity is measured by the value of that which is exported to pay for it.

Now we have imagined only two countries, and two commodities, but the case is exactly the same if we think of all countries and all commodities. England may buy raw cotton from the United States and sell cotton goods to India. India sells tea to the United States. England has paid for her raw cotton in cotton goods, but has done it through a third country, India, and a third commodity, tea.

A country can only pay for the things which it buys from another country by selling goods, or else performing services. Before the war, we, with our merchant ships, carried goods all over the world; we did a great part of the carrying trade of the world, and let us hope that we shall do it again. In return for this we received goods. A cargo boat took goods to different foreign ports and brought back other goods,

which, when sold, not only paid for the goods sent out, but for the services of the ship in carrying things from one port to another.

Suppose a country imported more goods and services than it exported, bought more than it sold, in other words. What would happen? The producers of the foreign goods have to be paid somehow, they are not sending things abroad out of charity but to make money. If the importing country can produce nothing that foreigners will buy, she must pay the balance in gold, for gold is the one thing that every country will always take.

But when gold moves about certain things happen. We shall be able to understand all this more clearly when we have studied *Money*, but for the moment we can say that when gold moves in or out of a country it will produce certain effects upon the prices in that country. The level of prices in any country depends partly upon the amount of gold it has, for price is simply a ratio between gold and the things gold buys. When these trading relations began, each country had a certain price-level, that is a certain quantity of gold in that country would buy a certain amount of goods and services. Or, if we like to put it the other way round, a certain amount of goods and services would buy a certain amount of gold.

Let us go back to England and Spain. Spain has bought a great many tram-rails, and England does not want any more oranges. Spain must make up the balance by sending gold. Therefore Spain has less gold and more goods than she had at first, gold is more valuable, goods are less valuable. That is, prices fall in Spain. But this means that though

Spain may be a very good country to buy from, as low-price places naturally are, it is not very profitable to sell to her. The people in England who import oranges will import rather more, as they are cheaper; the people, on the other hand, who export tram-rails will draw in their horns, selling to Spain has become a less profitable affair. Exports to Spain have been checked, imports encouraged, and once more a balance between imports and exports has been arrived at on the new basis.

This means that as soon as any country imports more than she can export to pay for her imports, or as soon as any country is selling (exporting) more than she buys (imports) forces are set at work which encourage the one and check the other. If she has an excess of imports, the forces will at once check imports, and give a stimulus to exports. If it is the other way round, these forces will have the opposite effect.

BILLS OF EXCHANGE

In actual fact a good many things will happen before gold begins to move. We reduced our problem to very simple terms, but let us now discover what really does take place. A merchant here in England has bought a cargo of Spanish oranges, and wants to pay for them. He does not want to send gold, which is an expensive operation. He tries to find some one else, to whom some Spaniard owes a debt. He finds the exporter of tram-rails. Instead of sending gold to Spain, he pays this exporter for the oranges, and arranges that his own creditor, the orange producer, shall be paid by the importer of tram-rails in Spain.

Of course, he does not really go wandering about England till he can find some one to whom Spanish money is owing. Foreign trade has made its own arrangements, and an extremely useful set of people has come into being, who deal in foreign debts and credits. They are called bill brokers, and our orange importer would simply have gone to one of them and asked for a Spanish bill. How much will he have to pay for his bill? This will clearly depend upon the demand for, and supply of, bills. If the amount of orange bills that wanted paying in Spain was just about the same as the amount of tram-rail bills that Spain wanted to pay in England, all he need pay would be the small sum that the bill broker charges for his services, which we remember from our arithmetic days.

But this may not be the case. Let us once more suppose that Spain has bought a large amount of tram-rails, and England only a few oranges. When the English importer goes to the bill broker he will find that that gentleman has quite a number of Spanish tram-rail debts that want paying, in fact he will be anxious to get rid of them, and will be willing to take less than their face value in order to do so. This is because the people who owe for those tram-rails know that if they cannot sell their debts to some one else who owes a debt in Spain, they will have to ship gold to England, and that is expensive. So the price of the tram-rail bills in England may go below their face value, but cannot, clearly, go farther below than the point at which it would not matter whether the bills were sold or the gold was shipped. The cost of sending gold is the downward limit, gold point

below, as it is called. Spanish debts will be at a *discount*.

But when the orange merchant discovers this he reflects. He thought he owed, shall we say £100, for oranges, and he finds he can buy the bill to pay that £100 for less than £100. Oranges are more profitable than he had supposed. He will order some more. We see what has happened. The excess of Spanish imports from England over Spanish exports to England has set to work forces which have encouraged Spanish exports to England.

Let us just cross over to Spain and see what happens there. The importers of tram-rails go to the bill broker to buy English debts. But there are not enough to go round, because there have been more tram-rails bought than oranges sold. So the tram-rail importers compete against one another for the orange bills; they will be willing to pay more for them than their face value, because of the cost of sending gold. How much more? Certainly not more than the cost of sending the gold, that is bills are at a premium, but the premium cannot go higher than gold point.

Meanwhile the tram-rail man goes away discouraged. He has had to pay more than he meant for his rails, he will make his next order a good deal smaller. What has happened? Again we see that an excess of imports at once sets in operation forces which discourage exports, that is raises the price of bills. Fewer tram-rails will be bought, more oranges sold, and once again a balance between imports and exports will be established.

When the number of people wanting bills upon any particular country, and the number of bills to be had

are just equal, exchange is said to be at *par*. When there are not enough to go round, and people are willing to pay more for them than their face value they are at a *premium*. When there are more than are wanted and people compete against each other to get rid of them they are at a *discount*. The height of the premium and the depth of the discount are limited by the cost of sending gold.

In real life, when the machinery of international trade is working smoothly, and is not, as it is now, badly upset by war, very slight rises and falls in the price of bills of exchange are enough to check or stimulate exports and imports, and the balance of trade remains fairly steady. If we judged by the figures, we should think that some countries imported much more than they exported, but, as we have seen, this cannot happen. The explanation is that such countries are being paid in goods for services they have rendered, or else they are being paid interest upon loans they have made to other countries. Similarly some countries seem to have an excess of exports. This may be because they are receiving services and paying in goods, or because they owe a debt to other lands upon which they pay interest. Other things, such as the sums spent by tourists, or remittances sent by people living in other lands, must also be taken into consideration.

FREE TRADE AND PROTECTION

It can now be seen that this theory of international trade is the basis upon which rests the economic

argument for Free Trade. There are any number of social and political arguments upon both sides, with which as economists we have no concern. What we can see is that if through tariffs any one import into a country is checked, some export, whether of goods or services, which would have paid for that import must be checked too. A tariff is a tax levied upon an imported commodity and imposed with the object of checking, or even of entirely preventing, its importation. Tariffs cannot make work, what they can do is to determine what sort of work shall be done. We may forbid the import of pianos, for instance, and so provide work for English piano makers. But we can only do so at the expense of some other industry which would have made something that would have been exported from England to pay for any pianos which had been imported.

Secondly, we must point out that such changes will probably mean a loss of wealth. Broadly speaking, the economist thinks that when there is no direction from governments, whether by tariffs or otherwise, both capital and workers are likely to find their way into the industries which pay them best, and that therefore the greatest amount of wealth will come into existence. If we insist upon the production of English pianos, we are benefiting the piano trade, but only at the expense of some other which would probably have been more profitable. (That is, if we are assuming that without the tariff there would have been an importation of foreign pianos.)

It is quite clear that countries may find it desirable to encourage some industry, not because it is more profitable, but because, although less profitable, it

is necessary for the general safety or wellbeing of that country. Some people, for example, think that agriculture should be protected, because of the importance of securing the food supply, and also because country conditions are healthier than town life, and the protection of agriculture keeps people, or helps to keep them, in the country. Again, most countries feel that they must be able to produce their own armaments. And again, many economists have agreed that a country may sometimes do well to make sacrifices in order to protect a new industry, which could only with great difficulty, if at all, compete successfully with similar industries already established in other lands. It is hoped that the loss may be temporary, the gain permanent.

The practical application of these arguments is naturally very difficult; for instance, it is hard to tell just how much protection such an industry really needs, and when it is sufficiently established to do without help. In short, there is an immense amount to be said on all these questions, but the arguments are mainly political, not economic, and if one is to judge them fairly one ought to make sure that one understands the economic result. What must be remembered is that a check to imports must mean a check to exports, and that it is important to weigh carefully the advantages and disadvantages. Tariffs or other interferences with the ordinary course of affairs have many effects; our business is only with the economic side. Here we must try to find out which is the export that has to be sacrificed, or rather what effect the proposed change will have upon our general export trade, and then we can make up our minds whether we think the change

is worth making, or whether it will do more harm than good.

It is also possible that the effect of protection upon the protected industry might not be wholly good. Sometimes the result of diminishing competition is to lessen the need for energy and ingenuity. The protected industry, or rather those responsible for its management, may take less trouble to improve and develop than they would otherwise have done. The result may even be that they become stupid and lazy, and that despite protection foreign competition may once more appear, whereupon the industry can think of nothing better than to demand still higher tariffs to protect it. None of this is inevitable, but it is certainly possible, even probable, and it has fairly often happened. On the other hand, industries which have only had themselves to depend upon have been known to be so spurred to efficiency by the competition of foreign producers as to bring about tremendous improvements in the business which perhaps they might not have undertaken, or might have postponed, had it not been for the effects of competition.

Suppose one country made boots, not only for itself, but for export. By-and-by a new kind of boot comes into demand, perhaps a thinner and lighter kind, because of the growth of cities and the increase of pavements and tramcars. Another country, in which city life has developed very rapidly, has worked out the necessary machinery for making this new kind of boot, and not only threatens to swamp the country of the original boot trade, but threatens all their foreign markets as well. What can the boot makers

do? Clamour for the protection of a tariff? Suppose they get one, they can indeed secure their own home market, or some part of it, but they can do nothing to keep the new boots out of the foreign markets to which they have hitherto sold many boots. So that the results of protection might be (1) a relief to the minds of those bootmakers who produced for their fellow-countrymen; (2) no relief, but great anxiety, to those who produced for foreign markets; (3) some annoyance to their fellow-citizens, who cannot get the new kind of boot, much as they want it, unless they are prepared to pay an increased price.

Now if they do not get protection, what will happen? Let us suppose that they are clever and resourceful people. They will send some one abroad to see how these new boots are made, they will import the necessary machinery, and use their own skill and experience of the boot trade to make these new boots, if they are what people are going to want. They may have a hard time for a bit, till they get used to it, but let us suppose that they are successful and make the new boots well enough and cheaply enough not only to supply their fellow-countrymen but also their foreign customers. Perhaps they will in the end even improve upon the imported machinery, not only make it at home, but make it better and the boots better too.

This sounds a little absurd, but the English boot trade did at one time pass through just such a crisis, and came out triumphant. There were demands for a tariff, but they were unsuccessful, and the boot manufacturers, thrown upon their own skill and that of their workers, soon recaptured their own trade,

kept their foreign markets, and even developed a large export trade to the country which had originally threatened them.

All these possibilities must be considered and duly weighed. The circumstances of different countries, different trades, and different times will vary. Sometimes it may be wise to sacrifice an immediate gain for the sake of a possible future one, or face an economic loss for the sake of a political gain. On all these questions there is room for wide and honest difference of opinion. But it is certainly of the first importance to understand something of what is entailed.

Since the great war all the conditions of foreign trade have been in such difficulty and confusion that much of the ordinary economic reasoning needs modification. But we must all hope that in due time order will once more return to a disordered economic world, and meanwhile there are plenty of problems and plenty of room for careful economic reasoning.

MONEY

WHAT IS MONEY?

ALMOST as soon as man began to exchange things he must have felt the need for something with which to measure. It is difficult and tiresome to reckon how much cloth shall be exchanged for corn, or skins for metals, although, no doubt, for many a long day man did perform these operations, at the cost of much bargaining and anxiety. Indeed, for the matter of that, he performs them still in primitive communities. But in time he came to find it a great help to have some one thing against which he could measure all the other things he wanted to exchange, so that he had only one set of reckonings to do instead of dozens. He also discovered another useful plan, and that was to have some one thing with which if he wished he could make payments. All trade is, of course, barter, but it is very convenient to be able to do your bartering in terms of some one thing which every one is willing to take, and which, therefore, can be used in all exchanges. In other words, man found that he needed *money*.

All sorts of different things are, and have been, used as money. Skins, cattle, slaves, and shells are only a few examples. Gradually most civilised nations came to use the precious metals, gold and silver, and by the end of the nineteenth century most of them had settled on gold.

Now in order to do the work of money really well the thing chosen should have certain qualities. In the first place it must be something which every one is always *willing to accept*, otherwise clearly it will be a very inefficient money. Imagine the position of some one who had sold his produce for what he thought was money, which he could use in his turn to buy the things he wanted, and then discovered that no one would be willing to take it in exchange for their goods or services. But if it is to be always acceptable it must have value of its own, for people are always willing to take that which has value because they know that they can always get something else in exchange for it. So the first essential for a good money is *value*.

Another quality which is important and very desirable, but uncommonly hard to get, is that the value of the money-thing should always remain about the same, so that any one who takes money in exchange for what he sells should be reasonably sure that when later on he spends the money it will buy as much as it did when he sold his goods. Nothing is more trying, as all of us who are living nowadays know to our cost, as changes in the value of money, that is in the amount of goods and services that our money will buy.

Then it should be something which is very difficult to destroy, not something which wastes away or is easily burnt or injured. Again, it is important that it should be easily divided, and that when it is divided it should not change its value. Diamonds would not be good money, because if you cut a diamond up each little bit is only worth a very small part of what the whole diamond would have fetched undivided.

Diamond chips are not very valuable, whole diamonds are, and the larger they are, the more precious they become. The increase in value is out of all proportion to the increase in size.

One of the obvious difficulties about the use of cattle or slaves for money is that they cannot be divided, and they are so large that they are no sort of use for small purchases. They are not very convenient for other reasons; for instance, they vary very much in quality. One cow might well be worth two or three others, so that if things were reckoned in cows one would have to be very careful to know what sort of a cow was meant. Gold on the other hand, if it is of a certain 'fineness,' can be divided and yet remain of the same value. Two half ounces of gold are worth just the same as one undivided ounce of gold, but two halves of a diamond are not, and one cannot think of half of a slave or a cow, unless indeed the cow is dead, and a dead cow is sadly wanting in one of the other qualities of good money, which is, as we have seen, indestructibility. Lastly, it should be easy to carry about and easy to recognise.

After many experiments then, we have settled, most of us, upon gold as being the thing which on the whole possesses most of these qualities in the highest degree. Many other things possess one or more of them, but on the whole gold possesses most.

Money, alas, is another of the tiresome words which are used to mean many different things, and it is sometimes convenient to call the sort of money of which we have been thinking *currency*. That is, it is something which runs, or passes readily from hand to hand. The word money is often used in daily life to mean

not only currency but also what we should call loanable capital; that is, the capital which has been saved and can be lent to those who want to use it. For example, the Money Market, about which there is a page, or part of a page, in most newspapers, is not concerned with currency, but with loanable capital. It is most tiresome that *money* should mean so many different things, but if we are on the look-out we ought to be able to guard ourselves against making mistakes. Plenty, however, have been made for want of distinguishing between the different meanings of that hard-worked word.

As gold is very valuable, that is, a small quantity of gold will exchange for many other things, it is found convenient to use substitutes for small purchases. In England gold is the *standard*, the real money, in terms of which everything else is measured, and before the war we all used it, and carried it about, that is if we were rich enough. But for small buyings and sellings it would be a nuisance to use tiny bits of gold, which would probably get lost, so that we used silver and copper to represent fractions of gold. Silver and copper coins are called *token* coins. The difference between them and sovereigns is that the value of the gold in a sovereign is the same as that of the same amount of gold if not coined. The value of the silver and copper in shillings and other coins is not. They are only *tokens*, that is convenient representatives of fractions of a sovereign, and they need not necessarily have any particular value in themselves. The chief reason why they are made of metals which are valuable in themselves is to guard against forgeries. It is extremely tiresome to have to test every

coin to see if it is genuine or not. So token coins are usually made of something fairly valuable, and are made in such a way as to be difficult to imitate. The main thing to remember about them, however, is that what one can buy with them does not depend upon the value of the silver or copper of which they are made, but upon that of the gold which they are used to represent.

It is also inconvenient to carry about large quantities of gold, so that another device has been found to avoid that difficulty. Banks print what we know as *bank-notes,* which are simply promises to pay so much gold, and these bank-notes can be used as money so long as people are sure that the banks can really pay out the gold in exchange for the notes if it is wanted.

Legal tender money is money which by law any man can use for the payment of his debts to any amount. With us, sovereigns and half sovereigns used to be (and still are, only we never see them) legal tender, so were Bank of England notes, about which there will be more to say when we come to *Banking.* Silver is only legal tender to the amount of 40s. and copper up to 1s. If some one owes a debt of 42s. and tries to pay it all in silver or copper the shop may, if it is obliging, take its debt in this form, but it may refuse, and the debtor will have to find the paper substitutes for a sovereign with which we have all grown familiar since the war, until the days when sovereigns return once more.

WHAT DETERMINES THE VALUE OF MONEY; THAT IS, THE LEVEL OF PRICES?

Now at this point it has become clear that both paper money and token coins are but representatives of gold, and that therefore we can ignore them and fix our minds upon gold. What settles how much we can get for our gold, and why does a certain amount of gold sometimes buy more and sometimes less?

As we saw when we were thinking about trade, the price of goods or the level of prices is but another way of describing the value of gold. If an ounce of gold will buy a certain number of yards of cloth, then so too will that number of yards of cloth buy an ounce of gold. It is the same thing the other way round. Only we are so used to reckoning things in terms of gold that our mental muscles rather ache when we try to reckon gold in terms of things. We think easily enough of the price of corn, but not so easily of the price of sovereigns.

What we need to remember is that the value of gold, like that of everything else, depends upon the demand for and the supply of gold. If gold is abundant, as it is, for example, in a gold-mining district, prices will be high, or in other words gold will be cheap. In the days when a penny was the ordinary fare for a bus or a tram, and halfpenny fares were, if short, quite often worth having in England, the shortest distance in Johannesburg cost threepence. This is because gold was produced near Johannesburg, and other things were relatively scarce. Gold was cheap, goods were dear. In most places, where the opposite

is the case, and where gold is scarce and goods are not, prices are low. Gold is dear, goods are cheap.

The demand for gold depends partly upon the use of gold for money work, partly upon its use for other purposes. When it does not take quite so many commodities to buy gold, in other words when gold is cheap, more people will have gold rings and gold necklaces. When it takes many things to buy gold fewer people will use it for ornaments. This double demand for gold helps to keep the supply steady, for when gold is cheap, that is, when there is a good deal of it, people will use it for commercial purposes, ornaments, and the like. This will draw away part of the supply of gold, there will be less of it available for money, and thus prices will be steadied again.

There are two elements which have to be considered in thinking of the *supply* of gold. One is the actual amount there is; the other, which concerns that part of the supply that is used for money, is how much it takes to do the work that money at the time has to do: in other words, the amount of exchanging which has to be done by means of money. Supply, that is, is amount, and rapidity of movement. If a coin changes hands half a dozen times, it does just the same work as six coins each changing hands once. This rapidity of movement is very variable, depending on all sorts of things. In agricultural districts, more money is needed at harvest time. Most of us use more at Christmas than at most times of the year, and more at the end of the week, when we do the family shopping, than at other times.

But broadly speaking, gold manages to move itself to where it is wanted, because every one is always

willing to take it. It moves itself through the machinery of price, as we have already seen. If there is much of it in any one place, in that place gold will be cheap, prices high. Therefore that place will be a good one to sell to, a bad one to buy from. Goods will come flowing in, gold will have to move out. In ordinary times, therefore, each country manages to have the amount of gold that it needs to do its money work. If it has too little, prices will be low, people will hasten to buy there and will be reluctant to sell. They will bring or send gold to pay for their purchases.

In the same way new discoveries of gold spread themselves over the world, and the new supplies are distributed to where they are needed. In the long run, the value of gold, that is the level of prices, must depend upon the expenses of production of gold. Only it is a very long run, because gold is not quickly consumed, it is all somewhere, and so any new supply is only a sort of ripple upon the surface. Still, what can be got in exchange for it does determine how much of it is produced, because the producers of gold, like the producers of anything else, have to be paid in goods and services for their work, and if the amount of goods and services they can get is not enough, no more gold will be mined. Gold will be dear, prices low. When that happens, people, finding that they can get many goods for their gold may feel inclined to melt down their ornaments, more gold will come into use as money, prices will once more begin to rise, more mining probably will be done, and again a balance will be attained.

INCONVERTIBLE PAPER MONEY

In our own days all these processes are very much interfered with, and prices jerk about in the most uncomfortable manner because the war has thoroughly upset all currencies. The governments of all the fighting countries needed an immense quantity of all sorts of things to carry on the war, and to pay for these things within their own countries they used their authority, printed bank-notes which did not really represent gold, and printed more and more of them as time went on. They used their gold to pay for their imports. They could not pay in goods because they were so busy making shells and guns and equipment that there were fewer goods to pay for exports. This is nothing new, it has almost always happened in time of war, it has always had the same disastrous result, and nevertheless it happens again.

Up to a certain point these notes work quite well. The government of the country that issues them says they are legal tender and backs them with its authority. People are willing to take them, because they can pass them on again, and get what they want with them. As long as there are only enough to do the money work that that country requires, all is well. But as a rule all soon becomes anything but well. We saw that the money work required to be done is a very variable amount, and that countries get the gold they need when they need it through the workings of the foreign exchange.

Suppose one country has as much money as it needs, gold and the new notes, say at Christmas. By

February it has much more than it needs, for February is a quiet time with little work for money to do. So as there is too much money, prices show an inclination to rise. Gold begins to leave the country, and prices steady again. But by March and quarter-day more money is needed. The government yields to the temptation and issues more notes. This goes on until all the gold is driven out of the country, or is perhaps hoarded, and then the prices of that country only depend upon paper. They are almost certain to rise, because as the paper is only useful inside its own country it cannot get out. No one else will take it. So what was enough at one time is soon too much, and prices rise. Then more notes are issued to keep up the new level.

This is exactly what has happened to us all, not only in England but to others as well, and very unfortunate it is. Each country has an artificial price level, and there is no means of steadying them and getting them into proper relations with one another, because each country is full of paper money which does not represent gold, has no sort of value, and can only be used inside the country which issues it. Much the same happened after the Napoleonic wars, and every one was made uncomfortable, just as we are, until at last the paper money was reduced to small quantities and prices were once more gold prices.

The purchasing power of money, that is, the amount of goods and services that a given amount of money will buy, has undergone many changes. We get examples of prices in the history books, prices that seem very different from those we know. Yet, although

competition worked but weakly, and neither people nor things could move with any considerable degree of freedom, so that prices depended partly on custom and only partly upon economic forces, the fundamental reasoning about money applied many centuries ago, as it does now. The theory of international trade and the definition of price are both admirably expressed in an old song:—

'The fairest pearls that northern seas do breed
For precious stones from eastern coasts are sold;
Nought yields the earth that from exchange is freed,
Gold values all, and all things value gold.

. . . . . .

No mortal thing can bear so high a price
But that with mortal thing it may be bought.
The corn of Sicil buys the western spice,
French wine of us, of them our cloth is sought.'

. . . . .

Gresham's Law, as it is called, dates from Elizabeth's time. Sir Thomas Gresham pointed out that bad money was liable to drive out good while good could not drive out bad. This is exactly what happens when governments issue paper money, that is, notes which cannot be changed back into gold. Every one uses the notes to pay with, the gold is hoarded or sent abroad. If a bad coin gets into circulation, most people will do their best to get rid of it, to pass it on. They may not be pursuing the most virtuous course, but, virtuous or not, it is the course which is usually pursued. Gresham's Law can only apply when the good and the bad moneys are both working together,

and when there is not enough work for them both to do. As long as they are both needed, both will remain at work. But if there is not enough for them both to do the bad will remain and the good will disappear.

Whenever in the past there has been a great increase in the amount of the precious metals, there has been a rise of prices and disturbances. As we know from our own experience, other causes may have the same effect, shortage of goods, as in war time, too much paper money, and other things which would take too long to discuss now. But a rise or fall of prices has certain definite results, some people suffer and others gain, in either case.

When prices rise, there is likely to be a stimulus to trade, people think they will get more money for what they have to sell, and they do not always realise that they will also have to pay more for what they buy. Borrowers gain. A man borrows £100 and it buys, let us say, a hundred commodities of some kind. When he repays his £100, some time later, it will only buy £95 of such commodities. He has paid back the same money, but its value is less. This tendency helps to encourage borrowers, and perhaps in this way gives a stimulus to trade, as trade is mostly conducted with the help of borrowed capital. But if it encourages borrowers, it must clearly discourage lenders, so that saving does not seem attractive. If what one saves will be worth less and less as time goes on, why not spend it now and enjoy it while one can? Moreover, rising prices are very hard on all those who have incomes of a fixed amount, pensioners, for example, or people who are living on their savings. It is hard,

too, on people who receive salaries or wages and cannot get them raised so as to make up for the increased prices.

We have all heard about these difficulties, and many of us have experienced them during the last few years. We have tried to get over them by paying 'war bonuses,' but many people who could not get bonuses have suffered sadly. It is not easy to alter wages either, they may get raised, and do, but it is very difficult to arrange for the rise to correspond exactly with the changes in price, so that in times of rapidly changing prices there are almost certain to be trade disputes and troubles about the rate of wages.

It is possible that some of the difficulty may be avoided in future by the use of a 'sliding scale.' A fairly accurate measure of the changes in the price level can be made by keeping lists of the prices of a number of those things which every one uses, coal, foodstuffs, clothing materials, and the like. Then by the aid of some skill in arithmetic the value of a given sum, say of £1, in different years, can be discovered, and wages can be graduated in such a way as to make their real worth, that is, the amount of goods and services that the wage-earner can obtain, remain about the same. The wage-earner may get a different number of coins, but what he can buy with them will remain the same. The war bonus paid to civil servants, for example, is calculated on these principles, and so too are the payments of railway servants and workers in some industries.

To sum up then. The level of prices depends upon the relation between the money supply, and the work that money has to do. Changes in price levels may

come from changes in the amounts of money, or from changes in the methods of production of goods, or from changes in methods of transport, or in the methods of carrying on business. As far as gold is concerned, in normal times, when the exchanges are working smoothly, the supply is automatically distributed among all the nations that use gold through the channels of foreign trade. Since the war all these channels are, so to speak, silted up by the currency troubles of the different countries, and we cannot hope to get back to steady prices, or to healthy conditions of trade, until currency is in a better condition.

Currency is only one of the reasons for our present troubles, but it is important, and the currency question, which used to seem rather abstract and unreal, is now one in which many of us take a living interest; and we are anxious to understand more about it, because we realise how much of our own personal comfort and happiness is affected by it.

BANKING AND CREDIT

BANK-NOTES AND CHEQUES

As we all know, many of our buyings and sellings are done not by means of actual money, but by substitutes which do the work of money. Sometimes we pay with bank-notes, sometimes with a cheque. Now how is it that these bits of paper, which clearly have no sort of value of their own, can and do perform money work?

Both bank-notes and cheques are promises to pay definite sums of money. We are willing to take bank-notes because we believe that the bank which issues the note will, if we present the note at its counter, give us in exchange gold, silver, and copper in the proportions we want. Bank-notes used in old days to be printed by many banks, but gradually these small note-issuing banks have gone out of existence, and become merged in banks of another kind, and practically the only note-issuing bank that we need consider in this country is the Bank of England.

The number of notes that the bank may issue is strictly limited by law (by the Bank Charter Act of 1844): that is, it can issue as many as it likes, but after a certain number, for every note it issues, it must keep in its cellars the amount of gold that the note represents. These conditions have been temporarily changed by the war, but before the war,

except in times of great emergency, the bank-notes really did represent gold, and every one knew that gold would always be given by the bank in exchange for its notes. This is still true, except of the war-notes—the £1 and 10s. notes in use now instead of sovereigns and half-sovereigns. Therefore bank-notes were most convenient methods of paying large amounts, and could even be used abroad, for so generally known was the fact that the Bank of England note really meant gold that almost every one was willing to take it and it could be used all over the world.

A bank-note then is a credit instrument, that is, it is a substitute for metallic money, and its acceptability depends upon the belief in the *credit* of the bank that issues it, a belief that the bank can and will give gold in exchange for it.

Now what is a cheque? A cheque is a written order by some one to his bank, to ask that bank to pay a certain sum upon the presentation of the cheque. The willingness of any one to take a cheque in payment of a debt, then, depends not only upon his belief in the bank upon which the cheque is drawn, but also upon his belief in the person who draws the cheque. Any one in England, and many people abroad, will take a £5 note in settlement of a bill. But they will not take a cheque for £5 unless they know the person who draws the cheque and believe in his honesty and credit. A bank-note, if it is backed by the authority of the government, and issued under special safeguards, may be currency, but a cheque cannot be anything but a substitute for currency, because its acceptability must depend entirely upon the economic character of the person who draws the

cheque, and the knowledge of that character on the part of the person who takes it.

We have now met several different methods by which debts may be paid. *Within a country*, they can be paid in the standard coin, up to a certain sum in token coins, in notes which do (convertible paper money), and notes which do not (inconvertible paper money) represent gold. They can also be paid by cheques and other credit instruments, provided that there is some knowledge as to the 'credit' of the people who draw the bills or cheques. *Between countries*, they can be paid in gold, or in bills of exchange, that is, bits of paper which represent goods. Token coins are no use, neither are bank-notes which do not represent gold; but bank-notes which do, and are well known to be readily exchangeable for gold, may occasionally be used. Cheques can sometimes be used, but probably what happens when we pay a debt to some one in a different country by means of a cheque is that we transfer the trouble of finding a bill of exchange to our bankers.

CREDIT

Credit clearly is a useful thing to have. Credit really means the belief on one person's part that another person can be trusted. We trust the bank; we are willing to take bank-notes. We trust a person, we are willing to take his cheque. If we give any one credit, that really means that we hand over to that person our power to buy a certain amount of goods and services. We cannot transfer what we do not

possess, and we shall not transfer it unless we think we shall get it back again.

The really important work of banks is the organisation of credit. They collect the purchasing power that some people have, and do not want for the moment, and enable other people who have not got it, and do want it, to make full use of it. A good banking system is like a good irrigation system: it collects all the little trickles of credit, accumulates them in suitable reservoirs, and out they go again into irrigation channels, bringing prosperity and productiveness with them.

Let us see how this actually works. Banks do two things: they accept deposits, and they make advances. The deposits are the little trickles or streams, the advances are the irrigation channels.

Suppose it is just before harvest time, and a farmer, who has a splendid crop, has not enough money in hand to pay all the heavy expenses of harvesting. He can go to the bank and ask for an advance. If the bank manager knows him, believes him to be an honest and reliable person, he will advance the amount he wants to tide him over until he can market his crop. The bank can do this in several ways, of which the easiest is by allowing the farmer an overdraft on his account. The farmer will have to pay something for this overdraft, that is, for the use of more purchasing power than he actually has, but he will be willing to pay, because it is worth his while. What he pays is really interest upon a loan. Or suppose that a manufacturer wants to instal a new machine, or enlarge his factory, in the same way he will go to the bank for a loan to enable him to do so. If the

banker thinks him capable and reliable, he, too, will get his advance.

But where does the bank get the necessary credit, or purchasing power, from which to make advances to the farmer or manufacturer? A bank cannot advance what it has not got, or at least if it does it will be pretty sure to come to grief. What it advances is the purchasing power of its depositors, which they do not want, and have left in the bank's care.

A school-teacher, or a works' manager, gets a salary, that is, the right to use a certain amount of goods and services, in return for his own services. He is paid quarterly. He does not wish to keep the money in the house, it would be an anxiety . He takes it to the bank, which will take care of it for him, and pay it out to him as he needs it. When he requires some of it he will write out a request to the bank to pay him a certain sum, that is, he will draw a cheque. Meanwhile the bank, with which he may have dealt for some time, will know that he will only want a third of it by the end of the first month, two thirds by the end of the second, and the remaining third will not be drawn out until the end of the quarter. The bank knows, therefore, that it can lend out that amount of purchasing power, some of it for one month, some for two, and some for three.

Taking the average of all its depositors, it will know fairly well how much at any time it can safely advance, and how much it must keep at hand in order to cash cheques. The more it can use, and get interest for that use, the more profitable will its business be. So that one of the things a successful bank manager has to do is to lend out, advance, as much as he possibly

can, and yet always have enough to provide his depositors with the cash they require. It is also to the interest of the community that credit should be as fully used as possible, for the more fully it is used the greater will be productivity. So that a good banking system is an extraordinarily important part of economic machinery.

MODERN BANKING

Banking systems have developed with immense rapidity in the last half-century. The old-fashioned bank made conditions as to the amount of the balance it expected its depositors to keep, and the size of the cheques they drew, conditions which meant that only rich people could have banking accounts. That is, the bank had comparatively few deposits, but they were large; it changed few cheques, but they were for substantial sums. Now banks are willing to change small cheques, certainly for anything over a pound, and often for sums below a pound, though every cheque means a certain amount of work and trouble for bank clerks, so that we might be inclined to think that few cheques and large ones would be preferable. They will also accept small deposits, and almost any one can now have a bank and a cheque book if he or she wishes.

The real reason for this change is that, though a few large depositors might mean little trouble, they also meant little return. If one of them died, or quarrelled with the bank, and withdrew his account, a large proportion of the bank's deposits was gone. A large, very large, number of small depositors gives a much safer

average; the larger the number the steadier, they are not likely all to die or withdraw at one and the same moment. But as few are rich, if banks want many they must provide the conditions which will suit the many, and this is what they have done. The result is admirable from the national point of view, for it means that the very best use is being made of the credit of as many as possible of the people who make up the nation. The reservoir, instead of being fed by a few streams, collects the waters of all the tiny brooks and streams, so that hardly a drop is wasted.

The older independent banks, of which we read in old-fashioned novels and memoirs, served only one district. To-day they are more likely to be branches of some great bank which has other branches all over the kingdom. Again this is economical, for it means that the credit of those districts where people save is placed at the disposal of the districts where people need capital. To use the irrigation idea once more, the older plan meant a number of smallish reservoirs, not connected with each other. The districts with a heavy rainfall would have more water than they could use, those which had but little rain would be parched. Now all the reservoirs are linked up, and the water can be distributed all over the country.

Advances can be made in several ways, and perhaps the most familiar after the temporary overdraft, is what is known as discounting bills. When a merchant sells something, instead of being paid at once, he usually expects to be paid in three months. But suppose he needs the money now. He can go to his bank, taking with him the bill, that is, the promise to pay three months hence, and the bank will pay

him, in exchange for the bill, not the whole amount, but the whole amount minus the interest it would earn during the three months. The owner of the bill can either wait three months and get the whole, or take it to the bank and get it discounted.

The banker is very willing to discount the bill, if it is a good bill, that is, one drawn upon a reliable firm or individual, for it is a convenient way of using the capital at his command. If he can keep a constant supply of bills coming in to be discounted, and the corresponding supply of bills being paid, he will have succeeded in using all his deposits as far as possible, and at the same time having always enough cash in hand. The owner of the bill will be pleased too. He needs the present value of the bill more than its future value, because if he has the use of the money now he can do more with it than he could with a larger sum three months hence. So it is a satisfactory arrangement all round.

Let us think of the farmer once more. This time he has not needed help from the bank before the harvest, he has got it all in, and everything has gone well. But the corn dealer, to whom he has sold the bulk of it, follows the usual custom and pays by a bill dated three months hence. That comes to near Christmas, and the farmer has several things for which he needs cash before then, perhaps a new horse or even a tractor. He thinks over the matter and decides to ask the bank to discount the corn merchant's bill. The money now is worth more to him, even allowing for the discount, than the total sum will be three months hence. The bank is delighted, and every one satisfied.

The Bank of England is in a special position. It is the heart of the English banking system. To begin with, it is the only bank which can issue notes that are legal tender, but it is also the bank with which other banks themselves deal, the bank of banks, and moreover it does all the banking of the government. It is easy to see what an immense amount of business must be involved by this. The government deals in millions, and the bank which does its work must necessarily handle very large sums, and hold a position of great responsibility.

The rate of discount decided upon at any time by the Bank of England is usually taken as the current rate by all the other banks. Therefore upon its wisdom much will depend. If the bank rate is raised, there is a check to borrowing, a stimulus to lenders. If it is raised too soon, or not soon enough, business may suffer. If borrowers are checked just at the moment when business is likely to revive after a period of slackness, or if the bank rate were not raised in time to stop a fit of wild speculation and over-trading such as is liable to attack even the sober business world, then in either case industry might be the worse for many a long day. Great indeed is the responsibility of the Bank directors.

Under the provisions of the Bank Charter Act of 1844 the two sides of the Bank of England are entirely separate. The Issue Department is solely concerned with the business of issuing bank-notes, and also acts as a link between the public and the Mint. If any one who has gold takes it to the bank, he will receive the appropriate number of sovereigns in exchange. The bank charges a very slight discount for this prompt

change, an amount which is supposed to represent the difference between the present worth of the sovereigns and the time it would take actually to coin the gold. The Banking Department carries on all the other business which has been described, and very important business it is, although its responsibilities are not quite so great now that the other big banking companies have become so large and important, and tend to rely less upon the help of the Bank of England than was the case in former years.

The business of banks, then, is to organise credit. They do it by taking the spare purchasing power of as many depositors as they can possibly obtain, and using this purchasing power by placing it at the disposal of people who need it, who can use it to increase wealth, and who have not got it. In order to attract as many customers as possible they now give facilities to quite small depositors, and the result is that their transactions are spread over a very wide area, and are therefore less likely to be upset by local disturbances. Of late years the old independent banks have gradually disappeared, though some still survive, and banking business is mostly done by the great joint-stock banks with branches all over the country. This is economical, not only because, as we have seen, it equalises the inflow and outflow of capital between the different parts, but also because each branch has the strength of all the other branches behind it, and is therefore very unlikely to get into difficulties. The 'run on the bank' and consequent collapse which so often occurs in story books does not, fortunately, happen to-day, though there have been sad instances of bodies which were not really banks at all but

fraudulent institutions. They appealed to the greed of the public by offering very high rates of interest, and in the end went bankrupt, leaving loss and misery to their unhappy customers. Leaving these aside, the existence of a good banking system, so organised as to make the very fullest use of the loanable capital (that is, the purchasing power not immediately required), of as many people as possible, is one of the most important parts of the economic machinery of any country, and one of the most vital agents in the production of wealth.

APPLIED ECONOMICS

PUBLIC FINANCE

RATES AND TAXES

As soon as people are grouped together into organised society they find it worth while to pay their government to do certain work for them. They need to be defended against attacks, they want justice, they want peace kept at home. As time goes on more and more work is undertaken by public bodies on behalf of the people they represent. To-day we have our government, acting for all the citizens, not only providing for the essentials of civilisation, peace, justice, and defence, but also for such matters as education, public health, and insurance, and also for all the complicated business which results from our relations with other countries, with the colonies and the self-governing dominions. There are also a number of local bodies, county and town and district Councils, doing any amount of work, cleaning and lighting and draining, carrying out the Acts which relate to public health and education, perhaps providing trams and gas and electricity.

All this, whether it is done by government or by the local Councils, has to be paid for. The citizens, that is, the electors, have to decide what shall be done

by government for them, and what they will leave to be done by private enterprise. Questions of this kind are continually under discussion, and the work of public bodies has increased enormously of late years. When the electors have decided what they wish their public bodies to do, they have next to face the less agreeable task of deciding how they will raise the money to pay for the work they require. As we all know, questions of taxation are settled by Parliament, questions of rates by local Councils. Both Parliament and the Councils are directed and controlled by the electors, who thus decide how much they wish to pay and what they want to have done for them. All this is the very groundwork of politics. Where does the economist come in?

He has a very important part to play. In the first place he can point out, if he is able to do so, the advantages and disadvantages, from the economic point of view, of handing over to the State any special service that may be under consideration. But it is also his business to point out, as far as he can, what will be the actual economic effects of any taxes which are proposed, to watch and explain the actual effects of those which already exist. It is one thing for Parliament to decide to impose some tax, it is quite another to work out exactly what the effect of that tax will be, and who in the long run will bear its burden. This is the work of the economist.

There are thus two sets of questions. In the first place, what services should be performed by public bodies, and next, which should be paid for nationally, that is, out of the taxes, which locally, that is, out of the rates? Putting it very shortly, it is usually found

convenient to pay locally for local work, for instance, the care of the roads, the local drains and light. It is also usual to pay locally, with some help from the taxes, for work which is national in character, but is actually done locally, for example, education and police. The people of the locality benefit from this kind of service, but it is of national and not only local importance. And sometimes it is convenient to arrange locally for national work because the people of the locality know more about their own conditions, and carry out the work more economically than would be possible for a national body.

The taxpayer and the ratepayer are always quarrelling. The ratepayer wants the taxpayer to help him, the taxpayer wants the ratepayer to do his own work. To a great extent they are the same people, but there are more taxpayers than ratepayers, as we shall see when we come to consider who pays rates and why, so that the ratepayer feels his burdens very heavy and is always trying to shift them on to the broader shoulders of the taxpayer.

The next set of questions is, How ought taxes to be levied? How should the public services be paid for?

Clearly the answer to this will partly depend upon the labours of the economist, who must work out the effects of any given tax, point out the people upon whom it will really fall, how they will be affected, and what the results of the tax are likely to be. Let us, as a wise precaution, first be quite sure that we know what we mean by a tax. A tax is a compulsory payment made by individuals to the government, in order to pay for the work of government. People pay taxes

because they have something, for instance, an income, a dog, a wheeled vehicle, or because they do something, for instance, import tea or make beer.

TAXES: THE QUALITIES OF A GOOD TAX

One of the things which people constantly forget is the rather obvious one that every penny which is paid out by the state or the municipality has first to be extracted from the pocket of somebody, and one of the functions of the economist is to consider whether that somebody is likely to use the money more economically than the public authority, a matter which partly depends upon the efficiency of the somebody and of the public body, and partly upon what each of them means to do with it. In any case, the operation of getting the money out of private pockets into the hands of the Chancellor of the Exchequer or the City Treasurer is bound to cost something, for it will not come by itself, nor will it go out again by itself when once it has got there.

One of the questions, then, that we ask about any proposed tax is whether it is likely to be expensive to collect, and, other things being equal, we prefer those which do not cost much to collect. Another question is how the tax can be paid with the least possible inconvenience to the payer. No one likes paying taxes, but some ways are less tiresome than others. And the taxpayer should know how much he has to pay. Nothing is less likely to encourage production than any uncertainty as to how much of what one produces is going to be demanded by the state. Taxes, then, should be, as Adam Smith

pointed out, as far as possible certain, cheap, and convenient.

That is comparatively easy. But when we get to the other condition laid down by Adam Smith, we are at once in difficulties. Taxes, he said, should be imposed in such a manner as to involve equal sacrifice upon the part of the payers. This is hard to manage. If we took the same amount, or even the same proportion of his income, from every one, we should be very far from having imposed equal burdens. Some people might starve if an eighth of their income were removed, some might be reduced below efficiency level, some might have to cut down their comforts, and the very rich would hardly feel it. Another trouble is that some people benefit much more than others from the work for which the taxes pay, so that they get more though they might possibly pay less. For instance, we could argue that the rich benefit most from the work of the police, because they have most to guard. On the other hand, public expenditure on wash-houses benefits only those who use the wash-houses.

It seems impossible to find any one tax which can be raised in such a way as to place an equal burden upon every one, and the best that can be done is so to arrange the whole system of taxation as to distribute the burden as fairly as possible between all the different taxpayers.

DIRECT AND INDIRECT TAXATION

This brings us to a consideration of the different kinds of taxes. They are usually classified under two

headings, direct and indirect, and though this is now supposed to be unscientific, it is convenient. *Direct* taxes are those which are paid by the people upon whom the burden of the tax falls. When any one pays 7s. 6d. for a dog licence, for example, that 7s. 6d. has to come out of his or her pocket, and cannot be recovered from any one else. An *Indirect* tax, on the other hand, is paid by one person, who does succeed in getting it from some one else.

The merchant who imports tea from India or China has to pay to the customs officer at the docks a tax of so much on each pound of tea. But he has not the remotest intention of bearing that burden himself. He adds it on to the price he charges for his tea, and it is probably paid, as a rule, by all the people who buy the tea. If the tax is diminished, the price of tea will probably fall, if it is increased, up goes the price of tea. All this has been brought home to us only too vividly by the war taxes upon such things as tea, tobacco, and alcohol.

It is worth while perhaps to note here that an indirect tax, that is a tax paid by some one who imports the taxed commodity, may be levied either because the government wants money, that is for revenue purposes, or because it wishes to keep the commodity out of the country, that is for protective purposes. If the tax is efficient in one way, it cannot possibly succeed in the other. If it brings in revenue, it does not keep the commodity out, if it keeps it out, it does not bring in revenue. It may do both badly, but it cannot do both well.

When we are trying to find out what really will be the result of a tax upon a commodity, what we must

consider is who uses that commodity, and how much they want it. If the demand is very elastic, and if something else can be substituted, the tax may bring in very little revenue. If, on the other hand, the article taxed is one for which the demand is inelastic, a thing which people will have and will be willing to pay more for rather than go without, then revenue will be obtained, if the commodity is one which many people need.

In theory it is very desirable to tax luxuries, because a tax upon luxury cannot diminish efficiency. But in practice it is seldom worth while to tax the luxuries that are only used by the few, because they bring in so little revenue. Every one wants to tax the rich, but when there are not many of them a tax on their particular luxuries is not much use. So that it is usual to place taxes upon those luxuries, such as tobacco and alcohol, or tea, which are used by every one. Such taxes are convenient, because they are included in the price of the commodity, and are paid for when it is paid for, but they are not as a rule cheap, because indirect taxation means a considerable number of customs officers and a good deal of expense.

As indirect taxation, if it is to be productive, must be imposed upon things which are used by every one, a little thought will show that it does not place an equal share of the burden upon every one. A poor woman spends a larger proportion of her income upon tea than does one who is better off, while the rich woman may spend actually more, because she buys a more expensive sort of tea, but much less in proportion to her whole income, than either of the others. So that a tax on tea means a heavier burden upon the poorer

woman than upon the richer, and the richer the person the lighter is the burden. If all taxes were indirect, then, an undue share of the burden would be laid upon the poorer classes of the community.

This brings us at once to direct taxes. Direct taxes are cheap, but they cannot be said to be convenient. No one likes having to pay lump sums, and many people who are accustomed to be paid weekly, and to pay weekly, find it extremely difficult to put aside enough to meet quarterly or yearly demands upon them for taxes or rates. On the other hand, if they know they are paying taxes—or rates—they are more likely to give thought to the question of whether they are getting their money's worth out of those taxes, while if they pay, without knowing it, in the price of the taxed article, they may not stop to think about this important question, and governments may get into extravagant habits. It was a statesman with a passion for public economy who said that the tax collector was the best schoolmaster.

One difficulty, however, there is about this side of taxation, and that is that as it is in practice found very difficult to extract a direct tax from people who are paid weekly, except small taxes like dog licences, we have a large number of people who have votes and determine policy, benefiting from the taxes perhaps, and not paying them, but placing them upon other people. This is not likely to lead to economy.

Our system of taxation includes both indirect taxes, which are mostly imposed upon things used by almost every one, and therefore fall more heavily upon poorer people than upon richer, and two great direct taxes, income-tax and death duties. There are

also what are known as *stamp duties*: that is, people have to place a stamp of a certain value upon various legal and other documents. Looked at all together, the burden of these taxes seems to be fairly evenly spread, though each one of them taken alone bears heavily upon one particular set of people.

THE INCOME-TAX

Let us think for a little about the *Income-Tax*. It is clearly unwise to remove any part of the income of a person who has only just enough to keep himself efficient. But how can we decide how much that is? It will vary according to the place in which he lives, the number of people dependent upon him, and the sort of work he does. A writer or inventor who works at home must have a room to himself, and that room must be quiet. Cheerful sounds from nursery or kitchen are not good for concentrated thought. This means a large house, and that means payments for help in keeping it clean and in repair. On the other hand, a man who does his work away from home welcomes company when he gets back. He can do with a much smaller house.

The tax system cannot take quite all this into consideration, but we do begin by letting off all whose incomes fall below a certain amount. It is a rough and ready way of providing against the taxation of what is necessary for the efficiency of the average person. Secondly, allowances are made for children of school age, and that is satisfactory. It is easy to see that a man with half a dozen young children is not at all in

the same position as another man with one, or none, even if he has the same income. Allowances are now made too for other dependents such as a helpless sister or mother, so that we are getting on.

Then when we think about it, we see that 2s. 6d. in the pound does not represent the same sacrifice to a man with an income of £1000 as it does to a man with an income of £500. It may only mean doing without luxuries to the first, but it may mean going short of comforts or even necessaries to the second. So the income-tax is graduated up to a certain point, and people with incomes of different amounts pay at different rates. It is not very tidily done, like so many English arrangements it has been done in bits, here a little improvement and here another, and it is not perfect by any means, but it is better than it was when the same number of shillings in the pound had to be paid by every one whatever their income.

Again, we see that a man who earns his income is not, in fact, as rich as the man who has an income of the same amount from investments, though the actual amount each gets in a year may be the same. But the man who earns has to provide for illness, for being out of work, for old age, and for his children, while the other need do none of these things. So that here again improvements have been made, and people pay at a lower rate upon earned incomes than they do upon incomes which come from investments, although this relief is denied to those who have more than a certain amount.

The *Death Duties* are paid when one person dies, leaving property behind, and before the successor takes possession, so that we might, if we wished, say

that no one paid them, but that the State takes a share out of the property before allowing it to be passed on. These, too, are graduated, and the amount partly depends upon the relationship of the person who dies to the person who inherits. They bring in a very considerable revenue, and as they fall more heavily on the very rich than upon those who are only moderately well off, they help to keep the balance even. For the only moderately well off are more heavily burdened by the income-tax and the indirect taxes than are the very rich.

A very high level of taxation, such as we endure after an expensive war, must mean that saving is checked to some extent, and that many people are very much inconvenienced. The Chancellor of the Exchequer, whose business it is to decide about these things, has always to remember that if a tax is too high it will not work. If a tax makes a commodity very expensive, people will do without it, if they possibly can, and the result of that is that little or no revenue is obtained. So that a low tax upon some commodity which every one uses is much more productive than a tax which is high enough to check the use of the taxed commodity. From the point of view of economy in collection, too, it is far better to tax only a few things than to tax many.

One of the reasons why Chancellors of the Exchequer want so much from the taxpayers is that over and over again they have been unable to make two ends meet, and have been obliged to borrow. The *National Debt* is the result of these borrowings. Every year a large number of millions has to come out of the pockets of all the taxpayers, and be paid

back again into the pockets of those or their heirs who were able to lend to the government in its need. They get interest upon their loans. Every government tries, some with success and some without, some with energy and some in a luke-warm manner, to get part of this debt paid off, and the sums put aside for the service of the National Debt allow not only for interest but for gradual repayment.

If all went well, the debt would slowly but steadily diminish. Unluckily all does not go well, and the efforts of many years are undone by one year of such a war as that which is just over. The history of the National Debt is the history of our wars. In war years it piles up, in peace years we try to pay it off. However, we can comfort ourselves by thinking that in so far as the National Debt is owed to ourselves (but a good deal of it is owed to others) it is only taken out of one pocket and put into another. This process, however, must cost something, so that what is taken out in taxes is bound to be more than what is put in as interest.

RATES

The principle upon which *rates* are levied is that the value of the house in which a person lives is a good rough working test of what he can afford to pay in rates. It is not by any means perfect, for obviously there may well be a poor man with a large family living in a big house, and a rich widow or bachelor, with no children, living in a small one. Still, perfection is hard to get, and it is not a bad standard. Most people live in houses which bear some relation to their

incomes. Broadly speaking, a house or shop or factory is rated at its supposed rental, after an allowance is made for repairs and insurance, and when the authorities of a town know from their rate book how much all these rentals come to, a simple process in arithmetic tells them how many pennies or shillings in the pound they must take from the ratepayers to provide them with what they need to carry on their part of the work of government.

There are certain difficulties; for instance a place with a very large number of small houses will only have a low 'rateable value,' but it will probably cost as much, perhaps even more, to run, as a place with large shops or other buildings which have a high rateable value. The unlucky people who live in the small-house locality will probably therefore have to pay a good many shillings in the pound. They are not unnaturally inclined to ask for help either from the taxpayer or from richer districts. It is easy to see that there are more taxpayers than ratepayers, because only the occupier, that is, the householder, in each house has to pay the rates, but there might quite easily be several taxpayers all living in the same house, to say nothing of wanderers in lodgings and hotels who drink tea, smoke tobacco, and consume alcohol, all operations which bring in a good deal to the tax-gatherer.

People who pay taxes and rates are anxious to shift them on to the shoulders of other people, if possible. How far they are able to get rid of their burdens will depend, as we should expect, upon the conditions of demand for and the supply of the thing that is taxed. Suppose there is a considerable rise in the rates, rent

and rates together come to more than the occupier of a certain house thinks he can afford. What will he do? If there are empty houses in the neighbourhood, that is if the supply of houses is in excess of the demand, he may be able to get his rent lowered. He will tell the house owner that unless the rent is lowered he will have to move.

But the house owner is probably only getting enough out of the rent to pay the interest on the cost of putting up the house, as well as repairs, insurance, and a reasonable return for his own work in house managing. He cannot bear the new charge. He will try to shift it back on to the land-owner, and how far he succeeds depends upon the sort of lease he has. But next time he wants a plot of land for building purposes he will take into consideration the amount of the new rates, and knowing about how much in rent and rates together the kind of tenant he has in mind can afford to pay, he will probably offer a lower rent for the land on which he means to build than he would have offered had the rates been lower.

If the demand for houses is in excess of the supply, a state of things with which we are all too familiar nowadays, the occupier will not even try to get his rent lowered, he will know that there are people waiting who will take his house if he leaves. He will perhaps take in a lodger, or do without a holiday or some other comfort. For the time being the burden remains upon him.

The same sort of reasoning applies in the case of a tax upon some articles, say sugar. The importer pays the tax, and at once passes it on to the grocer. He cannot afford to bear it, he is only making the

average rate of profit without which he would not go on working, so he passes it on once more and raises the price of sugar to all of us. What shall we do? Some of us, who have perhaps been a little extravagant, will buy less sugar. Others, who have only bought just as much as they must have and no more, will have to pay the new price. But they will have to do without something else, very likely something like jam or sweets, which have also become dearer owing to the new price of sugar. All this means less demand for sugar. Less is bought by the grocer and the people who make jam or chocolate, less is therefore ordered by the importer. Less, thus, can be sold by the growers in India or Jamaica or the other sugar-growing places, or if they grow the same amount they must find new markets.

If the markets they have hitherto had have been the most profitable, it looks as if some part of the burden of the sugar tax will be borne by them, but most by the sugar users, who need sugar and have to go on buying a good deal of it even if it is dearer. In so far as they do without something else, the result of the sugar tax will be to hit the producers of that something else, and we can even go on and say that if less sugar is imported, less of something, which used to be exported to pay for the sugar, will be sold, so that the sugar tax will hit a quite unexpected set of people who produced perhaps cotton or brass ware and exported it in return for sugar.

If the taxed commodity is one, unlike sugar, which people can do without, the result may be a falling off in the demand for the taxed article, and perhaps an increase in the demand for some other, which can be

used as a substitute. Here again there will be a disturbance of the markets, and the effects of the tax may spread into unexpected places. It is clear that the Chancellor of the Exchequer and his advisers will have to do a great deal of careful thinking before they impose any fresh tax upon us. It is also probable that less disturbance will result from slight changes in an old tax than from the imposition of a wholly new one.

If any one is inclined to doubt the value of economic teaching, or to think the subject unreal, not connected with the facts of everyday life, that doubter should study the history of English finance. Our system of taxation is not perfect, but it has stood some very hard tests, it has brought in an enormous revenue, which costs comparatively little to collect, and which in ordinary times imposes a burden that can easily be borne by the taxpayers. Just now, of course we are all suffering under the results of the greatest and most expensive of wars, and our burdens are undoubtedly heavy. But even so, the burdens that we have borne, the results of our methods as compared with those of other countries may well be taken as a triumph for British finance.

And our financial system is what it is, and as good as it is, largely because of the work and influence of the great British economists. Adam Smith, Ricardo, J. S. Mill, all have left their mark upon it, and in our own day those who have devoted themselves to the study of economic problems are constantly called in to advise the men who manage our finances. On Royal Commissions, special committees, and in close relations with the work of the Treasury, the economists

are at work. Like others, they are liable to make mistakes, but all of us ordinary people, who grumble at our income-tax or the price of tea or tobacco, owe a very great deal more than most of us suspect to the work of economists and to economic thought.

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